NEW ZEALAND FIXED INTEREST RESEARCH
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Mercury NZ Limited
Green Bond Offer

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Mercury NZ Limited (MCY) returns to the NZDX with its second "Green Bond" offering. MCY is undertaking an offer of up to NZ$200m (plus the ability to accept up to NZ$50m of oversubscriptions) of unsecured, unsubordinated, fixed rate (Green) bonds. The proceeds are intended to be earmarked to finance or refinance new or existing projects and expenditures relating to renewable energy.

Figure 1. Issue details

Issuer	Mercury NZ Limited	Maturity	29-Sep-2026	Key dates	
Security	Senior, unsecured	Credit rating	BBB+	Open	15-Mar-21
NZDX code	MCY040	Credit rating outlook	Stable	Rate set	19-Mar-21
Coupon*	2.21% to 2.36%	Min holdings	NZ$5k, 1k	Close	19-Mar-21
Amount on issue	NZ$200m (+ NZ$50m overs)	ISIN	NZMCYDG004C6	Issue	29-Mar-21
Interest Payments	Semi-annual	Registry	Computershare	Expected quotation	30-Mar-21
Indicative margin	0.85% to 1.00%	Supervisor	NZ Guardian Trust	First interest pymt	29-Sep-21

Source: Forsyth Barr analysis, *based on 5.5 year swap rate 15/3/2021

Already 100% renewable

At present MCY's electricity generation is 100% renewable, averaging around 6,600GWh p.a. Around 60% of the generation is achieved via nine hydro stations along the Waikato River. MCY (in partnership with Maori land trusts for two stations) also operates and owns (either in full or in part) five geothermal stations in the Central North Island.

Adding wind to the portfolio

MCY is undertaking the construction of New Zealand's largest wind farm, situated in Turitea in the lower North Island.

Rank equally with banks and USPP (kind of)

The Green Bonds rank alongside NZ$1,783m of MCY's liabilities, however, there is NZ$443m of debt that ranks above the Green Bonds, which includes United States Private Placement (USPP) and bank debt. This higher ranking debt benefits from guarantees from certain subsidiaries of MCY. As at 31 December 2020, these subsidiaries had total assets of NZ$1,975m. MCY's total assets (including all of its subsidiaries) are approximately NZ$6,787m.

No consequences if fail to comply

Like all other "Green" bonds in the New Zealand market there are no consequences for failure to comply with the "Green Bond" principles. There is no legal obligation on MCY to earmark the proceeds of the Green Bond to comply with the Green Bond principles or the Climate Bonds Standard on an ongoing basis.

Forsyth Barr Limited has been appointed as a Joint Lead Manager to the offer and will receive fees for undertaking this role including a fee based on the amount of bonds subscribed for by its clients. The offer is only being offered to investors who are resident in New Zealand. Full details of the offer are contained in the Terms Sheet. Potential investors should read the Terms Sheet thoroughly.

"Green Bonds"

The Green bond principles are voluntary with guidelines published by the International Capital Market Association. In order to issue "Green Bonds" there are four core components that must be considered:

- **Use of proceeds**: The proceeds of the Green bond must be used to finance or refinance assets or other projects that have clear environmental benefits.
- **Process for project evaluation and selection**: The issuer should provide clear information to investors about the issuer's environmental sustainability objectives; the process for evaluation of eligible projects; and the eligibility criteria.
- **Management of proceeds**: The issuer should have internal processes to track and attest to the use of the proceeds of the Green bond.
- **Reporting**: The issuer should make, and keep, readily available up to date information on the use of the proceeds of the Green bond.

The Climate Bonds Initiative (CBI) is an international organisation that promotes investments which will deliver a global low-carbon and climate resilient economy. CBI implements a Global Bond Standard covering investments such as Mercury's "Green" bonds. An issuer must receive both pre-issuance and post-issuance certification. In this instance CBI will look at MCY's internal processes, including its selection process for "Eligible Projects" and the internal tracking of the bond proceeds.

Eligible Projects

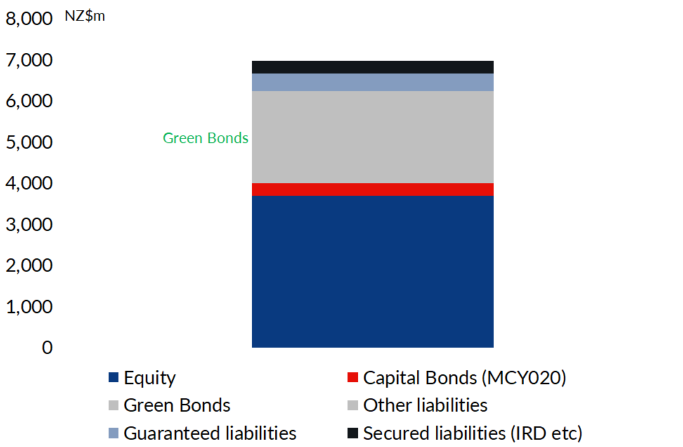
The proceeds of the bond issue are to be used towards the financing or refinancing of projects that have been identified by MCY as "Eligible Projects". Eligible Projects are categorised as follows:

- **Renewable energy**: The production, transmission, connection, appliances and/or products of renewable energy, such as wind energy, hydroelectricity, geothermal energy, and solar energy.
- **Energy efficiency and electrification**: Projects that contribute to a reduction of energy consumption, including energy storage (batteries), and electrical infrastructure.
- **Clean transportation**: Electric and hybrid transportation and infrastructure for clean energy vehicles and reduction of harmful emissions, including low carbon transport assets, systems and infrastructure, electric vehicles and charging infrastructure, and Information Communication Technology (ICT) that improves monitoring, measurement and management of assets to maximise utilisation. It must be noted that MCY may undertake non-eligible projects outside of the "Green" financing framework.

Well inside a key metric

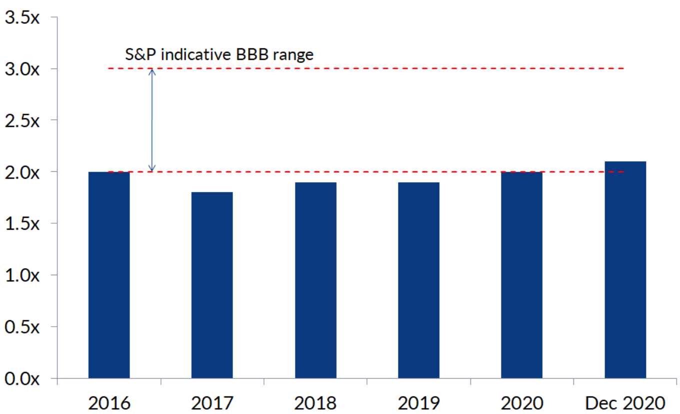
The gentailer sector abides by S&P's BBB debt to EBITDA credit metric. MCY, along with Genesis Energy (GNE), Meridian Energy (MEL) and Contact Energy (CEN) all have a stand-alone credit rating of BBB. MCY, MEL and GNE all receive a one-notch upgrade due to their government shareholding. While each company has their own target range, they are all relatively similar in maintaining a debt to EBITDA ratio (leverage) of between 2.0x and 3.0x. MCY is comfortably around the lower bound at 2.1x (31 December 2020).

Figure 2. Ranking



Source: Forsyth Barr analysis, as at 31 Dec 2020

Figure 3. Debt / EBITDAF



Source: Forsyth Barr analysis, Dec 2020 EBITDA based on NZ$520m FY21 guidance

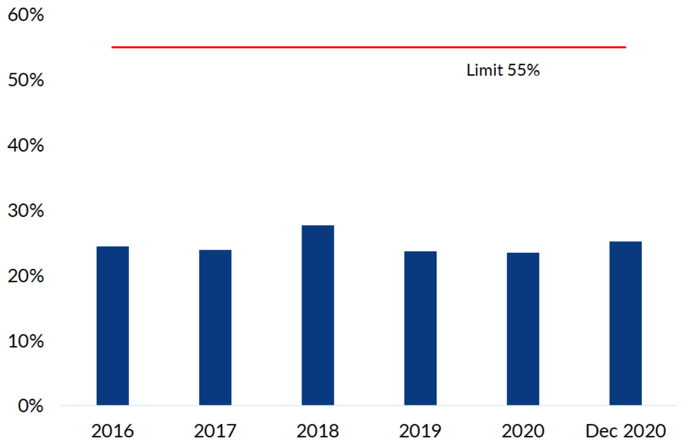
Covenants/Borrowing restrictions

There is one covenant which will see MCY ensure that Net Worth (shareholders' funds) will not at any time be less than NZ$500m. As at 31 December 2020, MCY's shareholder funds is around NZ$3.7bn indicating that this covenant is not overly demanding.

There is, however, a Negative Pledge Deed which contains two restrictions on MCY which bondholders do receive the benefit of:

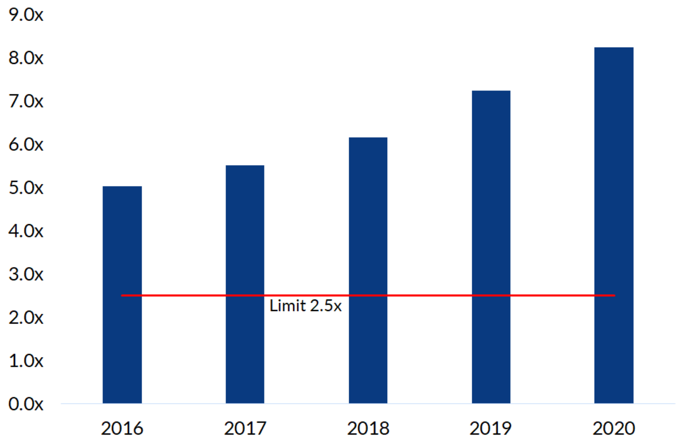
- The ratio of total debt to total debt plus shareholders' funds is less than 55%
- An interest cover ratio being EBITDA to total interest and financing costs greater than 2.5x

Figure 4. Gearing



Source: Forsyth Barr analysis

Figure 5. Interest cover ratio



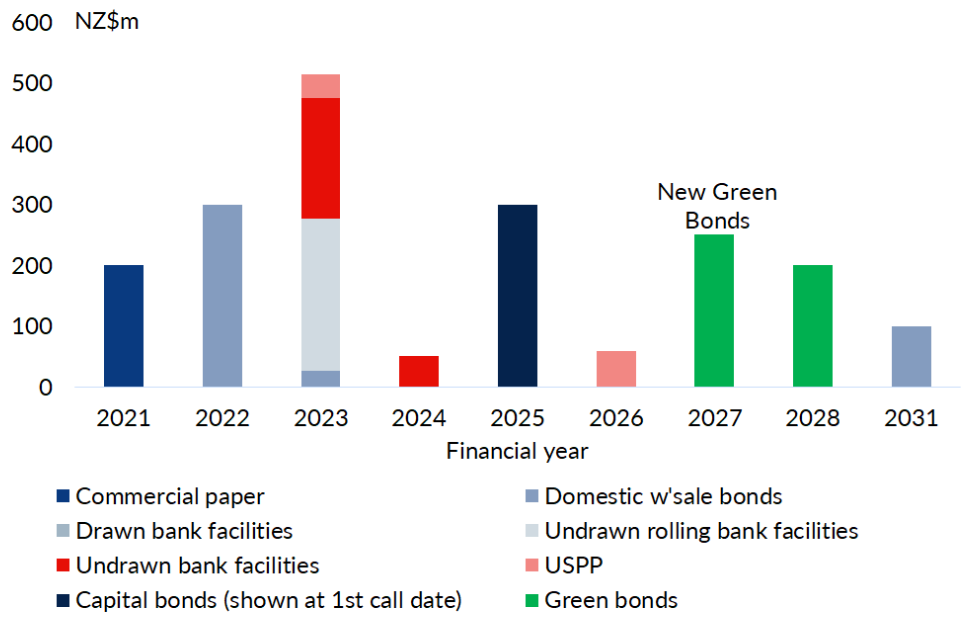
Source: Forsyth Barr analysis

Funding

MCY has a number of different funding sources including short-term Commercial Paper, Wholesale bonds, bank facilities and USPP funding. MCY also has a subordinated Capital Bond (MCY020) and a Senior Bond (MCY030), both quoted on the NZDX. As at 31 December 2020, MCY had NZ$500m of committed bank facilities maturing at various times over the next three to four years.

MCY's current dividend policy is to make distributions with a pay-out ratio of 70–85% of free cash flow on average through time, subject to a number of conditions such as credit ratings etc.

Figure 6. Maturity/Call profile



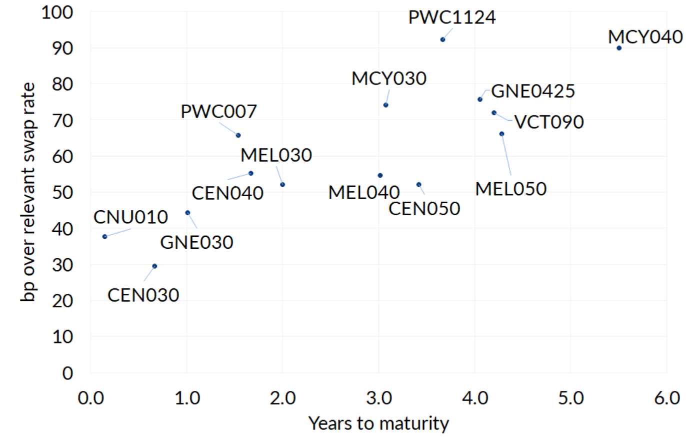
Source: Forsyth Barr analysis, MCY020 call date of 11/7/2024 used as expected to call, MCY is intending to partially repay a bank facility currently set to mature in Sept 2021

Comparative Securities

It was only September 2020 when MCY last came to the NZDX with its inaugural Green Bond. MCY030 was issued at a credit spread of 125bp over the seven year swap rate culminating in a coupon of 1.56% p.a. With the rise in mid to long-term interest rates the yield on MCY030 is now 2.31% on the wholesale market (credit spread of 79bp) or 2.25% (73bp) on the NZDX.

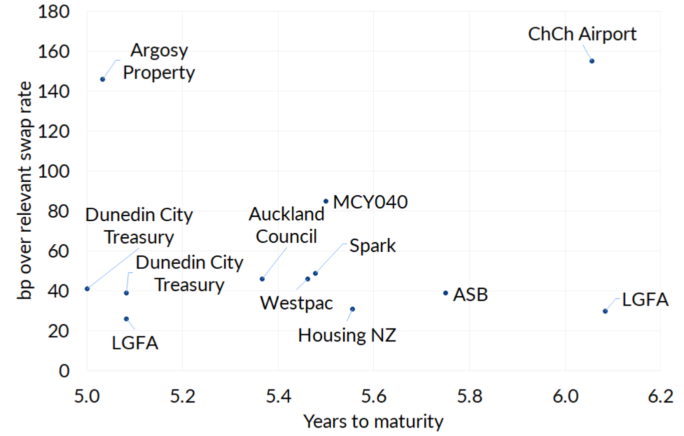
While there are currently 23 other "green" or "sustainable" labelled bonds available for investors in the New Zealand market (both listed and unlisted) this sector does not command a premium for its "green" or "sustainable" characteristics.

Figure 7. Gentailers: Secondary market credit spreads



Source: Forsyth Barr analysis, Thomson Reuters, MCY040 85bp

Figure 8. Secondary wholesale market credit spreads



Source: Forsyth Barr analysis, NZFMA, MCY040 85bp

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