

Mercury NZ Limited Green Bond Offer

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Mercury NZ Limited (MCY) is undertaking an offer of up to NZ\$150m (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. The funds will be primarily used for the financing and refinancing construction of MCY's Turitea wind farm near Palmerston North.

Figure 1. Issue details

Issuer	Mercury NZ Limited	Maturity	14-Sep-2027	Key dates	
Security	Senior, unsecured	Credit rating	BBB+	Open	31-Aug-20
NZDX code	MCY030	Credit rating outlook	Stable	Rate set	4-Sep-20
Coupon*	1.62% to 1.83%	Min holdings	NZ\$5k, 1k	Close	4-Sep-20
Amount on issue	NZ\$150m (+ NZ\$50m overs)	ISIN	NZMICYDG003C8	Issue	14-Sep-20
Interest Payments	Semi-annual	Registry	Computershare	Expected quotation	15-Sep-20
Indicative margin	1.25% to 1.45%	Supervisor	NZ Guardian Trust	First interest pymt	14-Mar-21

Source: Forsyth Barr analysis, *based on 7 year swap rate 31/8/20

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. The proceeds of this offer is expected to fund this wind project.

In its recent annual result, MCY indicated that it did not believe that the closing of NZAS would have a material impact on its business.

Rank equally with banks and USPP (kind of)

The Green Bonds rank alongside NZ\$1,783m of MCY's liabilities, however, there is NZ\$436m 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 30 June 2020, these subsidiaries had total assets of NZ\$1,928m. MCY's total assets (including all of its subsidiaries) is approximately NZ\$6,885m.

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.

To date there has been a few New Zealand corporates issue Green Bonds, such as Argosy Property (ARG), Contact Energy and Auckland Council with Meridian Energy also establishing a "Green Finance Programme" where all of its debt is now "Green". Whilst there appears to be an intention by some to establish a "Green" bond market, at present there is no premium (or discount) for bonds issued under a "Green" framework.

"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 is 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:

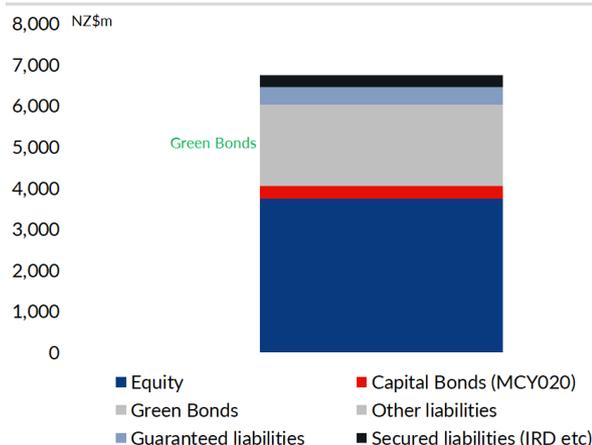
- **Renewable energy:** The production, transmission, connection, appliances and/or products of renewable energy, such as wind energy, hydroelectricity, geothermal energy, and solar energy.
- **Energy efficiency and electrification:** Projects that contribute to a reduction of energy consumption, including 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

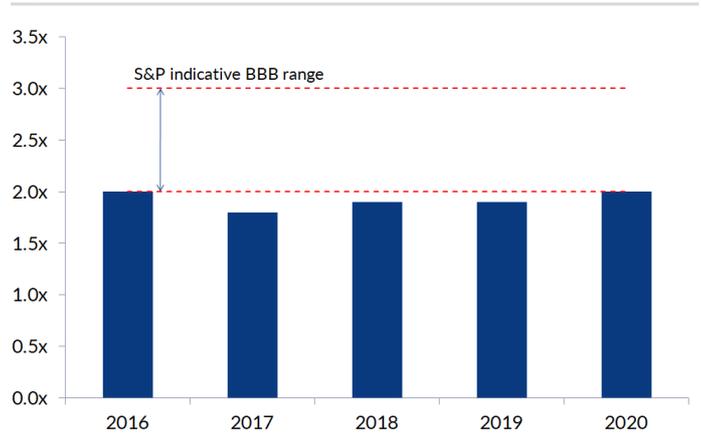
The gentailer sector abides by S&P's BBB debt to EBITDA credit metric. MCY, along with Genesis Energy (GNE), Meridian Energy (MEL) and Contact Energy (CEN) all have a stand-alone credit rating of BBB. MCY, MEL and GNE all receive a one-notch upgrade due to their government shareholding. While each company 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 of 2.0x (30 June 2020).

Figure 2. Ranking



Source: Forsyth Barr analysis, Mercury PDS, as at 30 June 2020

Figure 3. Debt / EBITDAF



Source: Forsyth Barr analysis

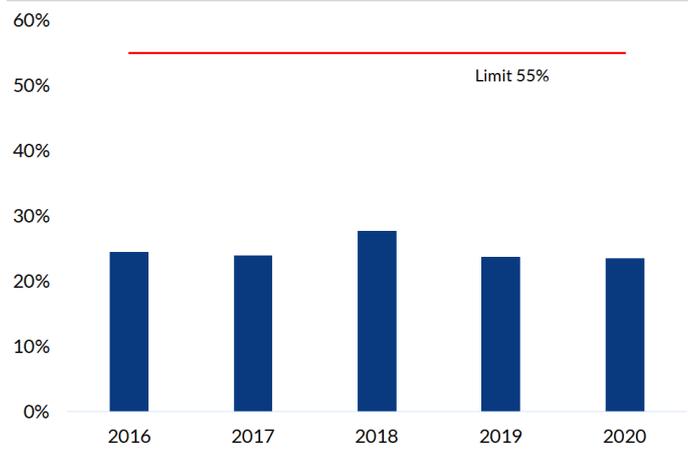
Covenants / Borrowing restrictions

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 30 June 2020, MCY's shareholder funds exceeded 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:

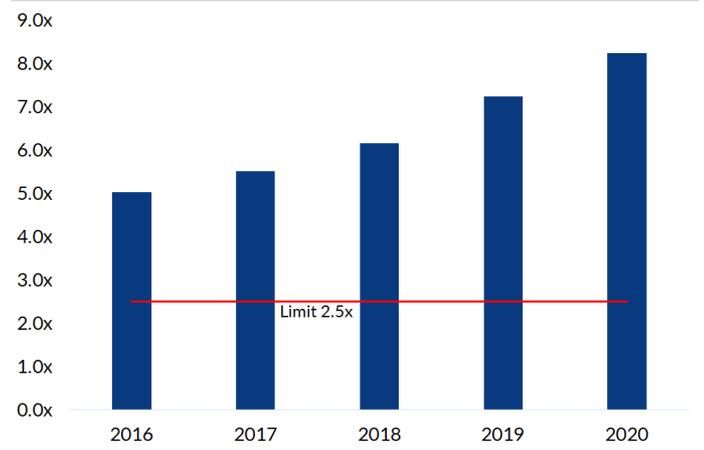
- The ratio of total debt to total debt plus shareholders' funds is less than 55%
- An interest cover ratio being EBITDA to total interest and financing costs greater than 2.5x

Figure 4. Gearing



Source: Forsyth Barr analysis

Figure 5. Interest cover ratio



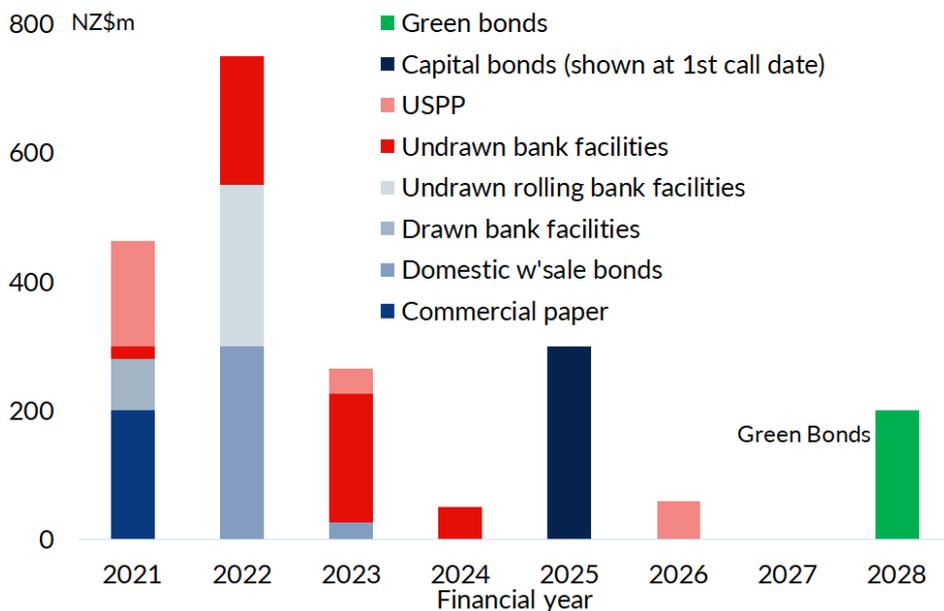
Source: Forsyth Barr analysis

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 quoted on the NZDX – MCY020. As at 30 June 2020, MCY had NZ\$800m 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



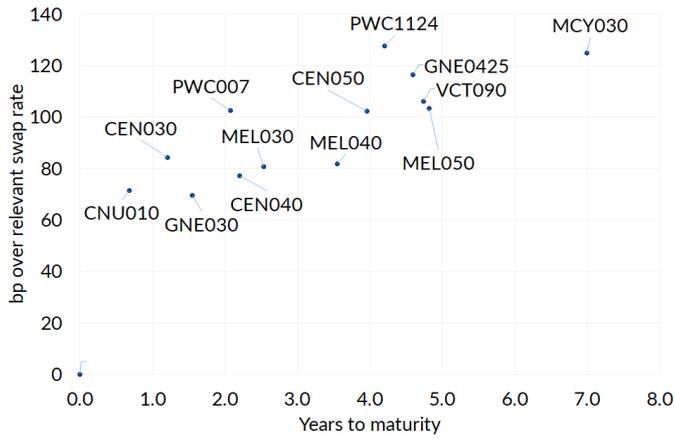
Source: Forsyth Barr analysis, MCY020 call date of 11/7/2024 used as expected to call, MCY is intending to cancel a bank facility post a successful bond issue

Comparative Securities

There has been relatively few debt issues in New Zealand in 2020; however, issues from Wellington International Airport (6yr at a credit spread of ~213bp) and Investore Property (7yr at 209bp) have been the most recent in the corporate sector.

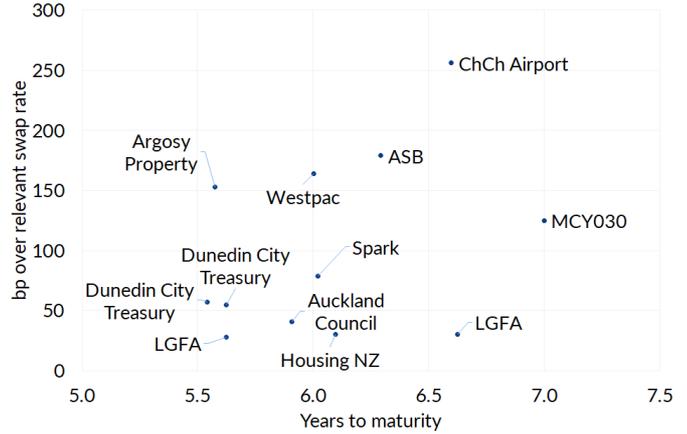
The government shareholding clearly plays a part in the pricing of MCY (and MEL and GNE) in this sector.

Figure 7. Gentaillers: Secondary market credit spreads



Source: Forsyth Barr analysis, Thomson Reuters, MCY030 125bp

Figure 8. Secondary wholesale market credit spreads



Source: Forsyth Barr analysis, NZFMA, MCY030 125bp

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