

Mercury

Downgrading on Big Uplift

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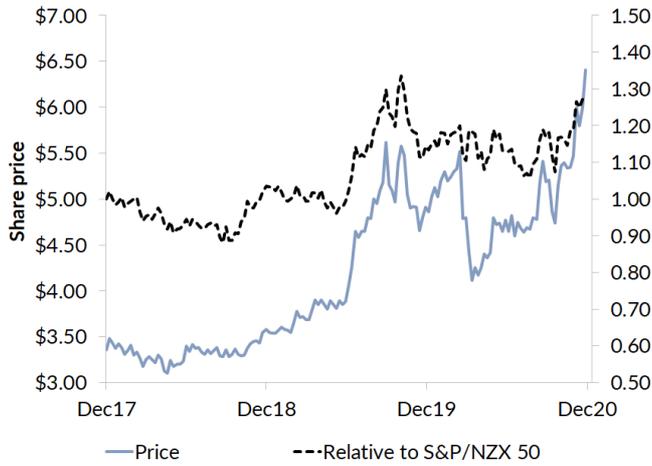
UNDERPERFORM

We are downgrading Mercury (MCY) to UNDERPERFORM from NEUTRAL. Since the beginning of November MCY's share price has rallied +20% with no news to justify the strong share price performance and outperforming the NZX50C +15.3%. In recent years the main driver of electricity stock share prices has been interest rates. In November the 10-year swap rate lifted +0.34% to 0.83%, collapsing the spread between MCY's gross dividend yield and the 10-year swap rate to less than 3.0% (a new low). Whilst we like the quality of MCY's assets and the industry it operates in, it is expensive and there are better value options in the market.

NZX Code	MCY	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$6.41	NPAT* (NZ\$m)	236.1	263.1	246.6	237.4	PE	37.0	33.2	35.4	36.7
Target price	NZ\$5.37	EPS* (NZc)	17.3	19.3	18.1	17.4	EV/EBIT	34.0	34.4	36.5	37.7
Risk rating	Low	EPS growth* (%)	-1.2	11.4	-6.3	-3.7	EV/EBITDA	20.0	19.2	19.6	19.7
Issued shares	1360.9m	DPS (NZc)	15.8	17.0	17.0	18.0	Price / NTA	2.4	2.4	2.5	2.5
Market cap	NZ\$8,723m	Imputation (%)	100	100	90	80	Cash div yld (%)	2.5	2.7	2.7	2.8
Avg daily turnover	745.8k (NZ\$3,667k)	*Based on normalised profits					Gross div yld (%)	3.4	3.7	3.6	3.7

Mercury NZ Limited (MCY)

Priced as at 03 Dec 2020 (NZ\$)						6.41						
12-month target price (NZ\$)*						5.37	Spot valuations (NZ\$)					
Expected share price return						-16.2%	1. DCF					5.06
Net dividend yield						2.7%	2. Market multiple					5.06
Estimated 12-month return						-13.6%	3. Dividend yield					5.14
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						1.30%	Total firm value					8,163
Equity beta						0.84	(Net debt)/cash					(1,277)
WACC						5.1%	Less: Capitalised operating leases					
Terminal growth						1.5%	Value of equity					6,886
Profit and Loss Account (NZ\$m)						Valuation Ratios						
	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E	
Sales revenue	2,000.0	1,750.0	1,843.8	1,608.9	1,638.7	EV/EBITDA (x)	19.1	20.0	19.2	19.6	19.7	
Normalised EBITDA	505.0	476.0	501.4	494.6	491.3	EV/EBIT (x)	31.9	34.0	34.4	36.5	37.7	
Depreciation and amortisation	(204.0)	(214.0)	(223.0)	(230.8)	(236.2)	PE (x)	36.5	37.0	33.2	35.4	36.7	
Normalised EBIT	301.0	262.0	278.4	263.8	255.1	Price/NTA (x)	2.5	2.4	2.4	2.5	2.5	
Net interest	(75.0)	(54.0)	(54.6)	(61.6)	(67.1)	Free cash flow yield (%)	2.7	1.5	0.8	1.8	2.8	
Associate income	1.0	18.0	1.3	1.7	1.9	Net dividend yield (%)	2.4	2.5	2.7	2.7	2.8	
Tax	(73.0)	(41.0)	(65.0)	(59.1)	(55.2)	Gross dividend yield (%)	3.4	3.4	3.7	3.6	3.7	
Depreciation capex adj	77.8	72.0	103.0	101.7	102.6	Capital Structure						
Adjusted normalised NPAT	239.0	236.1	263.1	246.6	237.4	Interest cover EBIT (x)	6.7	5.6	5.1	4.3	3.8	
Abnormals/other	118.0	(29.1)	(103.0)	(101.7)	(102.6)	Interest cover EBITDA (x)	6.7	8.8	9.2	8.0	7.3	
Reported NPAT	357.0	207.0	160.1	144.8	134.8	Net debt/ND+E (%)	61.8	63.2	67.2	71.7	75.7	
Normalised EPS (cps)	17.6	17.3	19.3	18.1	17.4	Net debt/EBITDA (x)	2.2	2.4	2.5	2.7	2.7	
DPS (cps)	15.5	15.8	17.0	17.0	18.0	Key Ratios						
Growth Rates						2019A	2020A	2021E	2022E	2023E		
Revenue (%)	11.2	-12.5	5.4	-12.7	1.9	Return on assets (%)	7.8	4.4	4.1	3.9	3.9	
EBITDA (%)	-10.8	-5.7	5.3	-1.4	-0.7	Return on equity (%)	4.6	4.4	4.4	4.0	3.9	
EBIT (%)	-17.7	-7.3	-0.1	-5.1	-3.2	Return on funds employed (%)	4.7	3.9	4.1	3.9	3.8	
Normalised NPAT (%)	-6.5	-1.2	11.4	-6.3	-3.7	EBITDA margin (%)	25.3	27.2	27.2	30.7	30.0	
Normalised EPS (%)	-6.4	-1.2	11.4	-6.3	-3.7	EBIT margin (%)	15.1	16.0	15.2	16.5	15.7	
Ordinary DPS (%)	2.6	1.9	7.6	0.0	5.9	Capex to sales (%)	6.1	12.7	13.6	10.1	5.7	
Cash Flow (NZ\$m)						2019A	2020A	2021E	2022E	2023E		
EBITDA	505.0	476.0	501.4	494.6	491.3	Capex to depreciation (%)	67	120	127	79	44	
Working capital change	2.0	92.0	(31.7)	(33.4)	(6.9)	Imputation (%)	100	100	100	90	80	
Interest & tax paid	(148.0)	(136.0)	(148.4)	(144.6)	(142.2)	Pay-out ratio (%)	88	91	88	94	103	
Other	2.0	(76.0)	0	0	0	Operating Performance						
Operating cash flow	361.0	356.0	321.3	316.6	342.2	Hydro	4,006	3,708	3,713	4,016	4,016	
Capital expenditure	(122.0)	(223.0)	(250.2)	(162.3)	(93.6)	Geothermal	2,894	2,812	2,841	2,841	2,841	
(Acquisitions)/divestments	215.0	0	54.5	0	0	Wind	0	0	77	543	838	
Other	12.0	4.0	(2.4)	(2.6)	(2.9)	Total MCY Generation (GWh)	6,900	6,520	6,632	7,399	7,695	
Funding available/(required)	466.0	137.0	123.3	151.7	245.7	GWAP (\$/MWh)	139	110	121	74	73	
Dividends paid	(208.0)	(214.0)	(220.5)	(231.4)	(235.4)	Electricity sales						
Equity raised/(returned)	0	0	0	0	0	Electricity customers (000)	373	348	343	349	356	
(Increase)/decrease in net debt	258.0	(77.0)	(97.2)	(79.6)	10.2	MM volumes	3,182	2,892	2,778	2,799	2,857	
Balance Sheet (NZ\$m)						2019A	2020A	2021E	2022E	2023E		
Working capital	63.0	(14.0)	17.7	51.0	57.9	TOU volumes	1,319	1,469	1,602	1,750	1,894	
Fixed assets	5,528.0	5,898.0	5,935.3	5,872.5	5,730.9	Total Fixed Price volumes (GWh)	4,501	4,361	4,380	4,549	4,751	
Intangibles	62.0	55.0	50.9	48.8	48.0	Spot Sales	780	746	750	753	757	
Right of use asset	0	0	0	0	0	Net CFD's	1,665	1,266	1,504	1,504	1,504	
Other assets	521.0	587.0	536.1	540.5	545.3	Total Sales (GWh)	6,946	6,373	6,634	6,807	7,012	
Total funds employed	6,174.0	6,526.0	6,539.9	6,512.7	6,382.1	Average usage per cust (MWh/yr)	11.8	12.2	12.7	13.1	13.5	
Net debt/(cash)	1,096.0	1,149.0	1,246.2	1,325.8	1,315.6	LWAP (\$/MWh)	145	115	127	78	78	
Lease liability	0	0	0	0	0	LWAP/GWAP	1.04	1.05	1.05	1.05	1.06	
Other liabilities	1,498.0	1,575.0	1,552.1	1,531.8	1,512.1	Average FPV price (\$/MWh)	113	118	119	113	111	
Shareholder's funds	3,580.0	3,802.0	3,741.6	3,655.1	3,554.4	Line losses (%)	5.1	4.9	5.2	5.1	5.2	
Minority interests	0	0	0	0	0	Energy margin (\$m)	667	652	679	675	675	
Total funding sources	6,174.0	6,526.0	6,539.9	6,512.7	6,382.1	Operating costs (\$m)	(199)	(190)	(192)	(195)	(199)	
						Other revenue (\$m)	37	14	14	14	15	
						MCY EBITDAF (\$m)	505	476	501	495	491	

Figure 1. Price performance


Source: Forsyth Barr analysis

Figure 2. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	52.6%

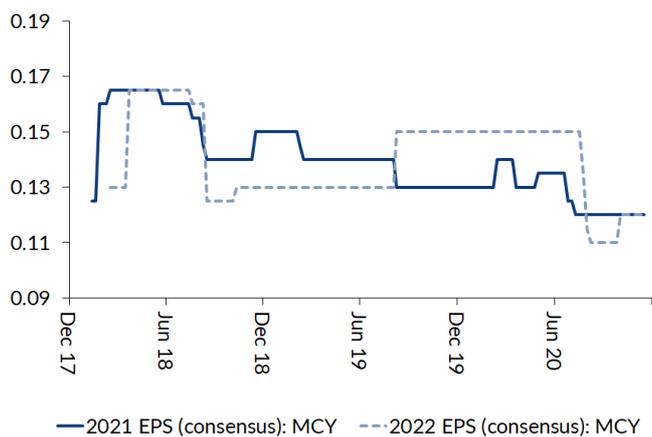
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 3. International valuation comparisons

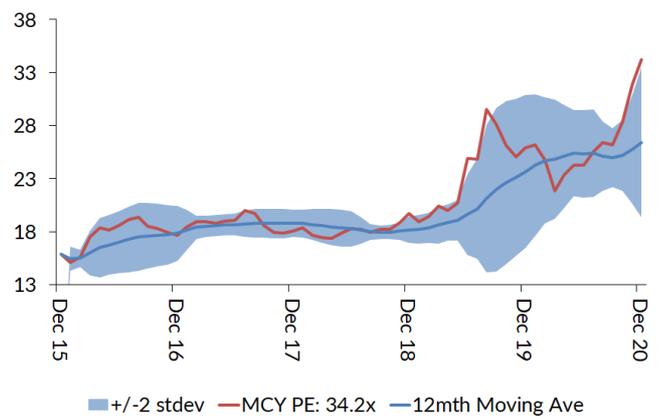
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
				2021E	2022E	2021E	2022E	2021E	2022E	
(metrics re-weighted to reflect MCY's balance date - June)										
Mercury	MCY NZ	NZ\$6.41	NZ\$8,723	33.2x	35.4x	19.7x	20.0x	35.3x	37.2x	2.7%
CONTACT ENERGY *	CEN NZ	NZ\$7.86	NZ\$5,648	22.8x	28.1x	14.4x	16.8x	31.8x	39.7x	4.1%
GENESIS ENERGY *	GNE NZ	NZ\$3.31	NZ\$3,454	18.3x	18.3x	11.6x	12.2x	24.6x	28.5x	4.2%
MERIDIAN ENERGY *	MEL NZ	NZ\$6.44	NZ\$16,503	37.0x	43.1x	23.5x	26.8x	39.1x	48.6x	2.6%
TRUSTPOWER *	TPW NZ	NZ\$7.30	NZ\$2,285	27.7x	29.2x	15.1x	15.4x	19.8x	20.5x	4.1%
AGL ENERGY	AGLAT	A\$13.54	A\$8,436	13.7x	17.0x	6.2x	6.9x	10.7x	13.2x	5.8%
ORIGIN ENERGY	ORG AT	A\$5.18	A\$9,123	22.9x	15.8x	6.4x	5.7x	23.0x	17.8x	4.6%
Compcop Average:				23.7x	25.3x	12.9x	14.0x	24.8x	28.0x	4.2%
MCY Relative:				40%	40%	53%	43%	42%	33%	-37%

EV = Current Market Cap + Actual Net Debt

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

Figure 4. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 5. One year forward PE (x)


Source: Forsyth Barr analysis

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