

Mercury

Taking a Tilt at Wind

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

NEUTRAL

In one fell swoop, once it has acquired Tilt Renewables' (TLT) New Zealand assets, Mercury (MCY) will become one of New Zealand's largest wind farm owners. MCY is acquiring TLT's NZ assets for NZ\$770m at an FY22 EV/EBITDAF multiple of 15.4x. We are positive on the deal as the price paid is reasonable (aided by the price it is receiving for its share of TLT's Australian assets) and the strategic benefits are significant. We estimate that the acquisition will lift MCY's dividends +3cps, ~+15%. We are lifting our target price +NZ\$0.35 (+6%) to NZ\$6.10/share and upgrade our rating to NEUTRAL.

NZX Code	MCY	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$6.03	NPAT* (NZ\$m)	236.1	290.4	346.4	358.2	PE	34.8	28.3	23.7	22.9
Target price	NZ\$6.10	EPS* (NZc)	17.3	21.3	25.5	26.3	EV/EBIT	32.2	29.9	23.5	22.5
Risk rating	Low	EPS growth* (%)	-1.2	23.0	19.3	3.4	EV/EBITDA	18.9	17.7	14.4	13.6
Issued shares	1360.9m	DPS (NZc)	15.8	17.0	21.5	25.0	Price / NTA	2.2	2.3	2.1	2.1
Market cap	NZ\$8,206m	Imputation (%)	100	100	80	70	Cash div yld (%)	2.6	2.8	3.6	4.1
Avg daily turnover	802.0k (NZ\$4,314k)	*Based on normalised profits					Gross div yld (%)	3.6	3.9	4.7	5.3

What's changed?

- **Earnings:** FY21 EBITDAF unchanged, FY22/FY23 increased +NZ\$40m/+NZ\$52m (+7%/+8%) to NZ\$633m/NZ\$668m
- **Target price:** Increased +35cps (+6%) to NZ\$6.10/share
- **Rating:** Upgraded to NEUTRAL from UNDERPERFORM

Strong deal on several counts, upgrading to NEUTRAL

MCY's acquisition of TLT's NZ assets is transformative and strategically a good move. In one transaction it will be a leading wind generator in NZ, with wind generation volumes equal to Meridian Energy (MEL). MCY's generation portfolio will be the most diversified renewable portfolio with wind making up ~23% of MCY's generation in normal years (hydro ~57% and geothermal ~31%). In addition, MCY now has a strong development pipeline as it has acquired all of TLT's development options.

MCY is paying NZ\$770m for TLT's NZ assets at an EV/EBITDAF multiple of 15.4x. The price is relatively full, however, is sweetened significantly by the price MCY is receiving for its TLT holding. The NZ\$7.80/share TLT transaction price means MCY will receive NZ\$586.5m, with the implied FY22 EV/EBITDAF multiple for the Australian assets 37.4x. The deal adds ~NZ\$50m EBITDAF (TLT is currently an associate) for a net outlay of ~NZ\$185m, which should result in a ~+3cps increase in MCY's dividend — another reason we like the deal. We are lifting our target price +6% to NZ\$6.10, due in large part to the price MCY is receiving for its TLT holding.

Several months to go before the transaction is completed, but it looks like a done deal

The transaction should be a formality from here, albeit it is expected to take ~five months to complete. The Scheme Implementation Arrangement is subject to OIO and FIRB approval in NZ and Australia respectively, although that should not be an issue given the acquirers of the NZ and Australian assets of TLT are local. The deal needs 75% shareholder approval, but with Infratil and MCY together owning 85% this also is not an issue. New Zealand High Court approval is also required.

Disclaimer: Forsyth Barr is advising Mercury on the acquisition of Tilt Renewables' New Zealand assets and will receive fees on completion of the transaction.

Mercury NZ Limited (MCY)

Priced as at 15 Mar 2021 (NZ\$)

6.03

12-month target price (NZ\$)*

6.10

Expected share price return

1.2%

Net dividend yield

3.4%

Estimated 12-month return

4.5%

Key WACC assumptions

Risk free rate

2.30%

Equity beta

0.84

WACC

5.5%

Terminal growth

1.5%

Spot valuations (NZ\$)

1. DCF

5.64

2. Market multiple

5.88

3. Dividend yield

6.04

DCF valuation summary (NZ\$m)

Total firm value

8,923

(Net debt)/cash

(1,241)

Less: Capitalised operating leases

Value of equity

7,682

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	2,000.0	1,750.0	1,996.6	2,163.1	2,135.9	EV/EBITDA (x)	18.1	18.9	17.7	14.4	13.6
Normalised EBITDA	505.0	476.0	512.1	631.7	666.4	EV/EBIT (x)	30.2	32.2	29.9	23.5	22.5
Depreciation and amortisation	(204.0)	(214.0)	(219.3)	(247.4)	(264.6)	PE (x)	34.3	34.8	28.3	23.7	22.9
Normalised EBIT	301.0	262.0	292.9	384.3	401.8	Price/NTA (x)	2.4	2.2	2.3	2.1	2.1
Net interest	(75.0)	(54.0)	(46.0)	(61.1)	(67.5)	Free cash flow yield (%)	2.9	1.6	1.9	3.8	3.9
Associate income	1.0	18.0	9.6	1.7	1.9	Net dividend yield (%)	2.6	2.6	2.8	3.6	4.1
Tax	(73.0)	(41.0)	(63.7)	(93.0)	(96.1)	Gross dividend yield (%)	3.6	3.6	3.9	4.7	5.3
Depreciation capex adj	77.8	72.0	107.7	114.5	118.2						
Adjusted normalised NPAT	239.0	236.1	290.4	346.4	358.2	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	118.0	(29.1)	(92.7)	260.5	(118.2)	Interest cover EBIT (x)	6.7	5.6	6.7	12.4	6.0
Reported NPAT	357.0	207.0	197.7	606.9	240.1	Interest cover EBITDA (x)	6.7	8.8	11.1	10.3	9.9
Normalised EPS (cps)	17.6	17.3	21.3	25.5	26.3	Net debt/ND+E (%)	61.8	63.2	63.6	56.1	57.8
DPS (cps)	15.5	15.8	17.0	21.5	25.0	Net debt/EBITDA (x)	2.2	2.4	2.2	2.0	1.9
Growth Rates	2019A	2020A	2021A	2022A	2023A	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	11.2	-12.5	14.1	8.3	-1.3	Return on assets (%)	7.8	4.4	4.5	10.5	5.6
EBITDA (%)	-10.8	-5.7	7.6	23.4	5.5	Return on equity (%)	4.6	4.4	5.0	5.8	6.1
EBIT (%)	-17.7	-7.3	8.0	27.6	4.6	Return on funds employed (%)	4.7	3.9	4.4	5.2	5.5
Normalised NPAT (%)	-6.5	-1.2	23.0	19.3	3.4	EBITDA margin (%)	25.3	27.2	25.7	29.2	31.2
Normalised EPS (%)	-6.4	-1.2	23.0	19.3	3.4	EBIT margin (%)	15.1	16.0	15.1	17.8	18.9
Ordinary DPS (%)	2.6	1.9	7.6	26.5	16.3	Capex to sales (%)	6.1	12.7	11.4	7.0	8.1
						Capex to depreciation (%)	67	120	120	69	74
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	100	100	100	80	70
EBITDA	505.0	476.0	512.1	631.7	666.4	Pay-out ratio (%)	88	91	80	84	95
Working capital change	2.0	92.0	(43.4)	(20.3)	(15.0)						
Interest & tax paid	(148.0)	(136.0)	(154.8)	(152.0)	(156.7)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	2.0	(76.0)	72.0	0	0	Hydro	4,006	3,708	3,786	4,016	4,016
Operating cash flow	361.0	356.0	385.9	459.4	494.7	Geothermal	2,894	2,812	2,852	2,838	2,838
Capital expenditure	(122.0)	(223.0)	(226.7)	(151.2)	(173.3)	Wind	0	0	0	1,222	1,585
(Acquisitions)/divestments	215.0	0	44.0	(195.0)	0	Total MCY Generation (GWh)	6,900	6,520	6,638	8,076	8,440
Other	12.0	4.0	54.9	(2.5)	(2.7)	GWAP (\$/MWh)	139	110	159	156	136
Funding available/(required)	466.0	137.0	258.1	110.8	318.7	Electricity sales					
Dividends paid	(208.0)	(214.0)	(220.5)	(254.5)	(313.0)	Electricity customers (000)	373	348	329	333	339
Equity raised/(returned)	0	0	0	0	0	MM volumes	3,182	2,892	2,701	2,641	2,686
(Increase)/decrease in net debt	258.0	(77.0)	37.6	(143.7)	5.7	TOU volumes	1,319	1,469	1,812	2,079	2,178
						Total Fixed Price volumes (GWh)	4,501	4,361	4,514	4,721	4,864
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Spot Sales	780	746	214	215	216
Working capital	63.0	(14.0)	28.4	48.7	63.7	Net CFD's	1,665	1,266	1,821	1,924	1,924
Fixed assets	5,528.0	5,898.0	5,866.0	6,542.4	6,449.9	Total Sales (GWh)	6,946	6,373	6,549	6,859	7,003
Intangibles	62.0	55.0	52.9	51.9	51.9	Average usage per cust (MWh/yr)	11.8	12.2	13.4	14.3	14.5
Right of use asset	0	0	0	0	0	LWAP (\$/MWh)	145	115	169	165	145
Other assets	521.0	587.0	458.7	262.9	267.6	LWAP/GWAP	1.04	1.05	1.06	1.06	1.06
Total funds employed	6,174.0	6,526.0	6,405.9	6,905.9	6,833.1	Average FPV price (\$/MWh)	113	118	124	127	127
Net debt/(cash)	1,096.0	1,149.0	1,144.4	1,288.1	1,282.5	Line losses (%)	5.1	4.9	4.9	4.9	4.9
Lease liability	0	0	0	0	0						
Other liabilities	1,498.0	1,575.0	1,580.4	1,584.2	1,590.0	Energy margin (\$m)	667	652	678	805	836
Shareholder's funds	3,580.0	3,802.0	3,681.1	4,033.6	3,960.6	Operating costs (\$m)	(199)	(190)	(185)	(188)	(184)
Minority interests	0	0	0	0	0	Other revenue (\$m)	37	14	19	14	14
Total funding sources	6,174.0	6,526.0	6,405.9	6,905.9	6,833.1	MCY EBITDAF (\$m)	505	476	512	632	666

Deal metrics

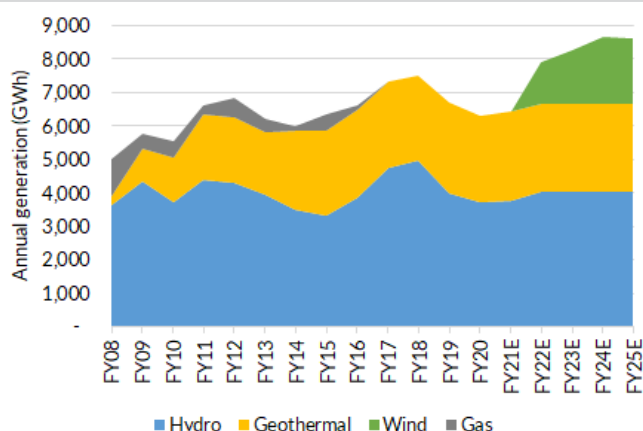
Figure 1. Deal metrics

		Headline price	"Effective" price	"Cash" price	
	Date	NZ\$m	NZ\$m	NZ\$m	Comment
Original TLT entry cost	May-18		144		Original entry price of NZ\$2.30/share
TLT equity raise	Feb-19		55		Equity raise for Dundonnell development
TLT capital return	Jul-20		(55)		Capital return following sale of Snowtown 2
Purchase of NZ assets	Mar-21	770	770	770	
Sale of TLT stake			(587)	(587)	TLT sale price of NZ\$7.80/share. EV/EBITDAF 27.7x.
MCY price paid for NZ assets		770	328	184	
FY22 EBITDAF (MCY guidance)		50	50	50	All of TLT's NZ assets have a fixed selling price
FY22 EV/EBITDAF		15.4	6.6	3.7	

Source: MCY, Forsyth Barr analysis

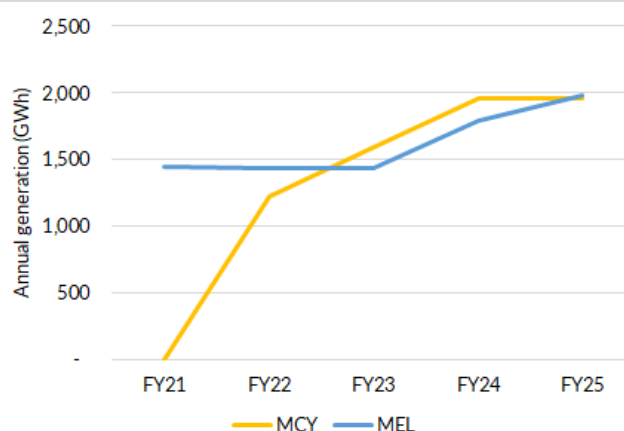
MCY's transformative generation journey

Figure 2. MCY generation by technology



Source: MCY, Forsyth Barr analysis

Figure 3. MCY vs. MEL wind generation volumes



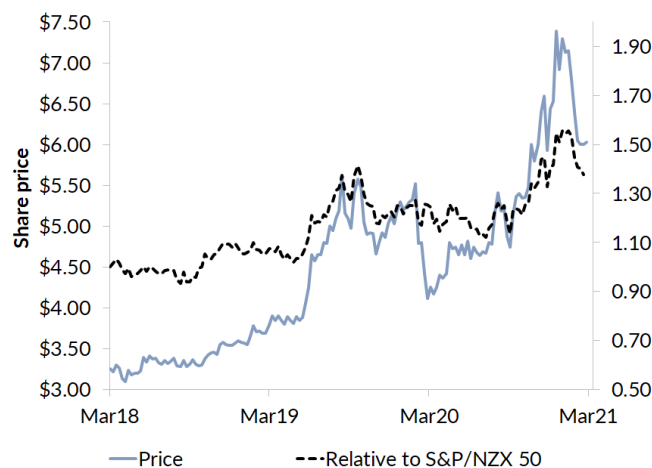
Source: Forsyth Barr analysis

Summary forecast changes

Figure 4. Summary forecast changes

	FY21	FY21		FY22	FY22		FY22	FY22	
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
Sales revenue	1,975	1,975	0.0%	2,086	2,147	2.9%	2,044	2,119	3.7%
Energy margin	678	678	0.0%	745	805	8.1%	762	836	9.7%
EBITDAF	522	522	0.0%	593	633	6.8%	617	668	8.4%
EBIT	307	307	0.0%	365	761	108.4%	382	404	5.6%
Pre-tax profit	261	261	0.0%	308	700	127.0%	323	336	4.1%
NPAT	198	198	0.0%	220	607	175.9%	230	240	4.2%
Normalised NPAT	183	183	0.0%	220	232	5.4%	230	240	4.2%
Dividend (cps)	17.0	17.0	0.0%	18.5	21.5	16.2%	22.0	25.0	13.6%
Generation (GWh)	6,638	6,638	0.0%	7,155	8,076	12.9%	7,318	8,440	15.3%
FPVV sales (GWh)	4,514	4,514	0.0%	4,721	4,721	0.0%	4,864	4,864	0.0%
Customer numbers (000)	329	329	0.0%	333	333	0.0%	339	339	0.0%
GWAP (\$/MWh)	\$159.0	\$159.0	0.0%	\$156.0	\$155.5	-0.3%	\$136.3	\$136.1	-0.1%
LWAP/GWAP	1.062	1.062	0.0%	1.057	1.060	0.3%	1.062	1.063	0.1%

Source: Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	52.6%

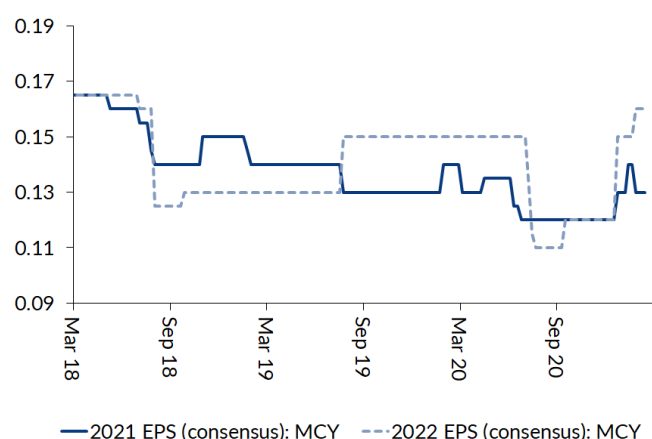
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

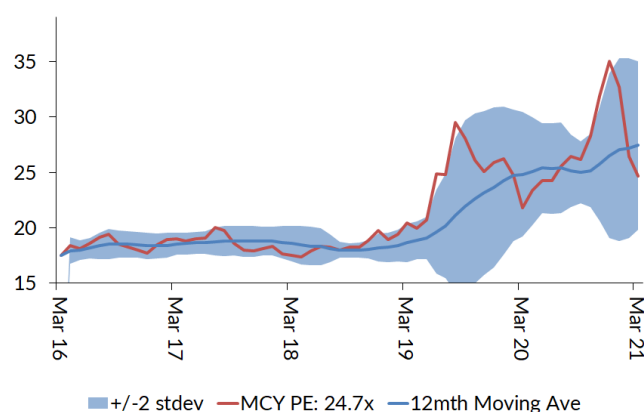
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect MCY's balance date - June)										
Mercury	MCY NZ	NZ\$6.03	NZ\$8,206	28.3x	23.7x	18.3x	14.8x	30.9x	24.2x	3.6%
CONTACT ENERGY *	CEN NZ	NZ\$7.20	NZ\$5,588	20.7x	19.9x	13.8x	13.5x	26.4x	25.6x	5.1%
GENESIS ENERGY *	GNE NZ	NZ\$3.88	NZ\$4,049	19.4x	17.2x	12.6x	12.0x	24.6x	22.9x	4.5%
MERIDIAN ENERGY *	MEL NZ	NZ\$5.77	NZ\$14,786	37.8x	35.2x	23.4x	22.1x	41.7x	37.8x	3.0%
TRUSTPOWER *	TPW NZ	NZ\$8.08	NZ\$2,529	29.6x	25.7x	16.1x	14.5x	20.9x	18.5x	4.2%
AGL ENERGY	AGL AT	A\$9.83	A\$6,124	11.4x	15.5x	5.3x	6.1x	9.6x	12.7x	6.2%
ORIGIN ENERGY	ORG AT	A\$4.66	A\$8,207	25.6x	16.2x	6.6x	5.8x	25.6x	20.7x	5.0%
Compco Average:				24.1x	21.6x	13.0x	12.3x	24.8x	23.0x	4.7%
MCY Relative:				17%	10%	41%	20%	25%	5%	-24%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MCY) 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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