FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | UTILITIES | ELECTRICITY GENERATOR/RETAILER
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Meridian Energy
Tough 1Q21 - Downgrading to NEUTRAL

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NEUTRAL

We are downgrading our Meridian Energy (MEL) rating to NEUTRAL following a tough 1Q21 and due to limited dividend upside, even if NZAS remains open. Following two stellar years, 1Q21 has proved to be more challenging with below average hydrology impacting earnings such that we are downgrading our FY21 EBITDAF forecast -NZ$46m (-6%) to NZ$748m. In addition, relative to other electricity stocks dividend upside if NZAS remains open beyond August 2021 is limited due to MEL likely having to provide a significant electricity price discount to NZAS and due to record FY20 earnings pushing up MEL's ordinary dividend. We have trimmed our target price -6cps to NZ$5.44/share.

NZX Code	MEL
Share price	NZ$5.04
Target price	NZ$5.44
Risk rating	Low
Issued shares	2563.0m
Market cap	NZ$12,918m
Avg daily turnover	1,773k (NZ$8,449k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	510.3	433.4	383.3	359.8
EPS* (NZc)	19.9	16.9	15.0	14.0
EPS growth* (%)	5.9	-15.1	-11.6	-6.1
DPS (NZc)	19.3	16.9	16.9	16.9
Imputation (%)	75	75	75	65
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	25.3	29.8	33.7	35.9
EV/EBIT	26.6	32.6	39.8	43.0
EV/EBITDA	16.9	19.3	21.7	22.8
Price / NTA	2.6	2.7	2.8	3.0
Cash div yld (%)	3.8	3.4	3.4	3.4
Gross div yld (%)	5.0	4.3	4.3	4.2

Rating downgrade to NEUTRAL

There are two factors that have lead to our rating downgrade. First, relative to other electricity stocks, there is limited dividend upside if NZAS remains open. Strong FY20 earnings pushed up the FY20 ordinary dividend, such that even at the top end of MEL's free cash flow payout range (75% to 90%), it needs ~NZ$720m EBITDAF to maintain its current 16.9cps ordinary dividend (although MEL has indicated it is prepared to temporarily go above the 90% payout if necessary). Given the support MEL will provide NZAS to stay open, we expect earnings to be around NZ$700m if NZAS stays (lower if NZAS closes). We do not expect MEL will reinstate its capital management "special" dividend.

The second issue is the short-term headwinds MEL is facing from below average hydro generation.

FY21 forecast downgraded on lower generation volumes

We have cut our FY21 EBITDAF forecast -6% to NZ$748m, with a -4% (-490GWh) reduction in our generation volume assumption the main driver of the decline. Our FY22 and beyond forecasts are unchanged as we await the final decision on NZAS.

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Meridian Energy Limited (MEL)

Priced as at 07 Oct 2020 (NZ$)	5.04

12-month target price (NZ$)*	**5.44**
Expected share price return	7.9%
Net dividend yield	3.4%
Estimated 12-month return	11.3%

Spot valuations (NZ$)	
1. DCF	5.13
2. Market multiple	4.93
3. Dividend yield	5.46

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.81
WACC	5.1%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	15,058
(Net debt)/cash	(1,903)
Less: Capitalised operating leases	
Value of equity	13,155

Profit and Loss Account (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Sales revenue	4,104.0	4,102.0	3,700.8	2,962.1	2,900.8
Normalised EBITDA	**838.0**	**855.0**	**753.6**	**669.6**	**639.1**
Depreciation and amortisation	(276.0)	(312.0)	(308.1)	(303.6)	(300.6)
Normalised EBIT	**562.0**	**543.0**	**445.6**	**366.0**	**338.5**
Net interest	(83.0)	(84.0)	(79.5)	(81.4)	(86.7)
Associate income & other	(7.0)	(219.0)	(22.0)	(4.0)	0
Tax	(133.0)	(63.0)	(94.8)	(76.7)	(68.5)
Minority interests	0	0	0	0	0
Reported NPAT	**339.0**	**177.0**	**249.3**	**203.8**	**183.3**
Abnormals/other	143.0	333.3	184.1	179.4	176.5
Adjusted normalised NPAT	**482.0**	**510.3**	**433.4**	**383.3**	**359.8**
Normalised EPS (cps)	18.8	19.9	16.9	15.0	14.0
DPS (cps)	21.3	19.3	16.9	16.9	16.9

Valuation Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EV/EBITDA (x)	17.1	16.9	19.3	21.7	22.8
EV/EBIT (x)	25.6	26.6	32.6	39.8	43.0
PE (x)	26.8	25.3	29.8	33.7	35.9
Price/NTA (x)	2.4	2.6	2.7	2.8	3.0
Free cash flow yield (%)	4.4	4.2	3.1	2.4	2.8
Net dividend yield (%)	4.2	3.8	3.4	3.4	3.4
Gross dividend yield (%)	5.3	5.0	4.3	4.3	4.2

Capital Structure	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Interest cover EBIT (x)	6.7	3.9	5.3	4.4	3.9
Interest cover EBITDA (x)	10.1	10.2	9.5	8.2	7.4
Net debt/ND+E (%)	76.9	96.6	108.8	126.4	152.0
Net debt/EBITDA (x)	1.7	1.9	2.2	2.6	2.9

Growth Rates	**2019A**	**2020A**	**2021A**	**2022A**	**2023A**
Revenue (%)	24.5	0.0	-9.8	-20.0	-2.1
EBITDA (%)	25.8	2.0	-11.9	-11.2	-4.6
EBIT (%)	41.2	-3.4	-17.9	-17.9	-7.5
Normalised NPAT (%)	33.6	5.9	-15.1	-11.6	-6.1
Normalised EPS (%)	33.6	5.9	-15.1	-11.6	-6.1
Ordinary DPS (%)	10.9	-9.2	-12.6	0.0	0.0

Key Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Return on assets (%)	5.7	3.4	4.6	4.0	3.8
Return on equity (%)	6.1	6.3	5.1	4.4	4.2
Return on funds employed (%)	5.9	5.8	4.9	4.1	3.9
EBITDA margin (%)	20.4	20.8	20.4	22.6	22.0
EBIT margin (%)	13.7	13.2	12.0	12.4	11.7
Capex to sales (%)	1.7	1.5	2.0	4.7	1.9
Capex to depreciation (%)	28	22	27	50	20
Imputation (%)	66	75	75	75	65
Pay-out ratio (%)	113	97	100	113	120

Cash Flow (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EBITDA	**838.0**	**855.0**	**753.6**	**669.6**	**639.1**
Working capital change	(36.0)	49.0	(33.7)	(6.9)	(15.2)
Interest & tax paid	(200.0)	(251.0)	(218.0)	(202.9)	(200.3)
Other	33.0	(48.0)	(22.0)	(4.0)	0
Operating cash flow	**635.0**	**605.0**	**480.0**	**455.7**	**423.6**
Capital expenditure	(69.0)	(63.0)	(75.4)	(139.4)	(55.4)
(Acquisitions)/divestments	0	(2.0)	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**566.0**	**540.0**	**404.6**	**316.4**	**368.1**
Dividends paid	(500.0)	(546.0)	(433.1)	(433.1)	(433.1)
Equity raised/(returned)	(2.0)	(2.0)	0	0	0
(Increase)/decrease in net debt	**64.0**	**(8.0)**	**(28.5)**	**(116.7)**	**(65.0)**

Operating Performance	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Hydro generation	12,326	12,758	11,847	10,600	11,113
Wind generation	1,244	1,466	1,447	1,430	1,430
Total NZ generation (GWh)	**13,570**	**14,224**	**13,294**	**12,030**	**12,543**
GWAP ($/MWh)	123	89	97	55	45
Overseas generation (GWh)	730	642	771	810	810
Overseas GWAP ($/MWh) (NZD)	269	381	366	376	384
Overseas customer numbers (000)	110	136	159	174	183
NZ electricity customers (000)	**302**	**324**	**349**	**380**	**407**
Average usage per cust (MWh/yr)	13.2	13.9	13.8	13.8	13.7
Mass market volumes	3,901	4,342	4,657	5,023	5,382
Time of use volumes	2,338	3,034	3,594	4,205	4,624
Total fixed price volumes (GWh)	**6,239**	**7,376**	**8,251**	**9,228**	**10,006**
NZAS sales	5,310	5,431	5,011	842	0
Sell CFDs	2,239	2,527	1,902	2,902	2,792
Buy CFDs	(1,965)	(2,731)	(2,218)	(1,496)	(1,496)
Total Sales (GWh)	**11,823**	**12,603**	**12,946**	**11,476**	**11,302**
Average FPVV price ($/MWh)	105	108	105	98	94
LWAP ($/MWh)	132	95	108	65	56
LWAP/GWAP	1.07	1.06	1.11	1.18	1.25
Lines losses (%)	5.9	4.8	5.5	5.5	5.5

Balance Sheet (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Working capital	(24.0)	(64.0)	(13.9)	(9.5)	(1.4)
Fixed assets	8,825.0	8,594.0	8,366.0	8,202.9	7,957.4
Intangibles	59.0	65.0	60.4	59.2	59.6
Right of use asset	0	0	0	0	0
Other assets	383.0	441.0	419.0	415.0	415.0
Total funds employed	**9,243.0**	**9,036.0**	**8,831.4**	**8,667.6**	**8,430.6**
Net debt/(cash)	1,424.0	1,616.0	1,644.5	1,761.3	1,826.2
Lease liability	0	0	0	0	0
Other liabilities	2,362.0	2,337.0	2,293.3	2,248.6	2,203.5
Shareholder's funds	5,457.0	5,083.0	4,893.6	4,657.8	4,400.9
Minority interests	0	0	0	0	0
Total funding sources	**9,243.0**	**9,036.0**	**8,831.4**	**8,667.6**	**8,430.6**

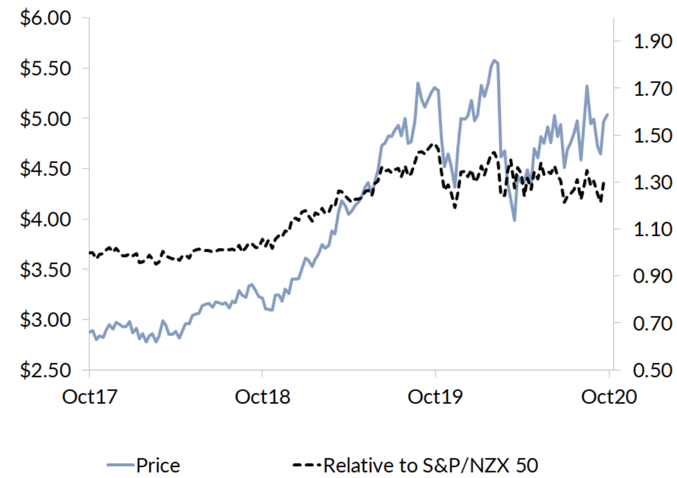
Summary forecast changes

Figure 1. Summary forecast changes

	FY21 Old	FY21 New	% Chg	FY22 Old	FY22 New	% Chg	FY23 Old	FY23 New	% Chg
NZ Energy Margin	1,049	1,003	-4%	901	901	0%	884	884	0%
Australia Energy Margin	110	110	0%	114	114	0%	113	113	0%
EBITDAF	**794**	**748**	**-6%**	**663**	**663**	**0%**	**632**	**632**	**0%**
EBIT	485	440	-9%	359	359	0%	331	331	0%
Pre-tax profit	385	338	-12%	275	274	0%	246	245	-1%
NPAT	277	244	-12%	198	197	0%	177	176	-1%
FY dividend (cps)	16.9	16.9	0%	16.9	16.9	0%	16.9	16.9	0%
NZ Generation (GWh)	13,782	13,294	-4%	12,029	12,030	0%	12,543	12,543	0%
FPVV sales (GWh)	8,251	8,251	0%	9,228	9,228	0%	10,006	10,006	0%
Customer numbers (000)	349	349	0%	380	380	0%	407	407	0%
GWAP ($/MWh)	$85.0	$97.2	14%	$55.0	$55.0	0%	$45.1	$45.1	0%

Source: Forsyth Barr analysis

Figure 2. Price performance



Source: Forsyth Barr analysis

Figure 3. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	51.0%

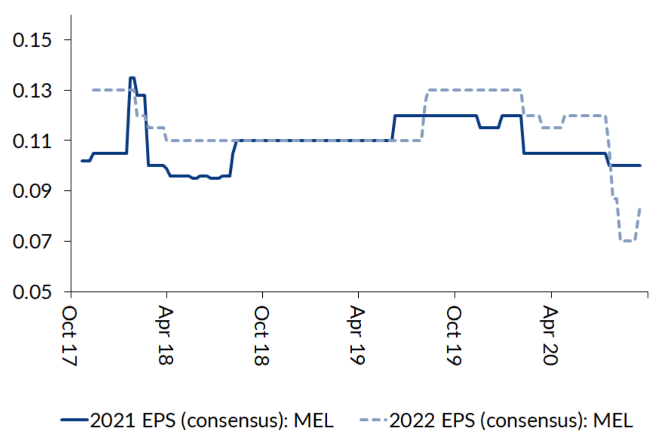
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect MEL's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Meridian Energy	**MEL NZ**	**NZ$5.04**	**NZ$12,918**	**29.8x**	**33.7x**	**19.3x**	**21.7x**	**32.6x**	**39.7x**	**3.4%**
CONTACT ENERGY *	CEN NZ	NZ$6.93	NZ$4,977	20.1x	24.8x	13.0x	15.1x	28.6x	35.7x	4.6%
GENESIS ENERGY *	GNE NZ	NZ$3.05	NZ$3,178	16.9x	16.8x	11.0x	11.8x	23.5x	29.1x	4.6%
MERCURY *	MCY NZ	NZ$5.15	NZ$7,016	26.7x	28.4x	16.3x	16.5x	29.2x	30.7x	3.3%
TRUSTPOWER *	TPW NZ	NZ$7.16	NZ$2,241	25.0x	24.8x	14.8x	14.8x	19.6x	19.5x	4.2%
AGL ENERGY	AGL AT	A$13.50	A$8,411	13.7x	16.5x	6.2x	6.8x	10.6x	12.7x	5.9%
INFIGEN ENERGY	IFN AT	A$0.93	A$898	>50x	n/a	10.6x	n/a	22.0x	n/a	n/a
ORIGIN ENERGY	ORG AT	A$4.26	A$7,503	18.8x	12.4x	5.4x	4.9x	19.2x	14.2x	5.5%
			Compco Average:	**20.2x**	**20.6x**	**11.0x**	**11.6x**	**21.8x**	**23.7x**	**4.7%**
EV = Current Market Cap + Actual Net Debt			**MEL Relative:**	**48%**	**64%**	**75%**	**86%**	**49%**	**68%**	**-29%**

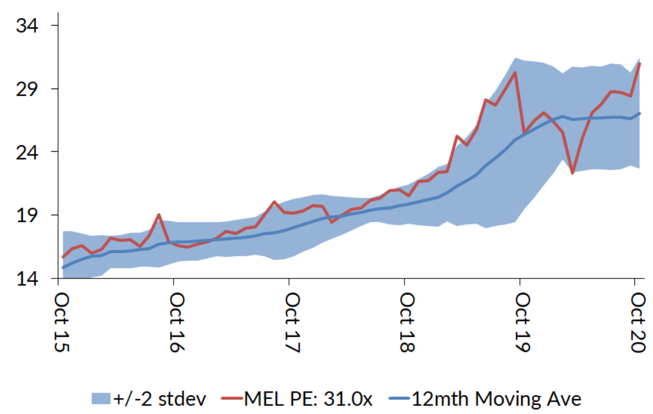
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MEL) companies fiscal year end

Figure 5. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 6. One year forward PE (x)



Source: Forsyth Barr analysis

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