

# Meridian Energy

## Return of the Smelter

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### UNDERPERFORM

Whilst Meridian Energy (MEL) holds the electricity contract with NZAS, it is not the main beneficiary of NZAS remaining open as it will be receiving materially less for its electricity. The estimated NZ\$83m per annum discount MEL is providing NZAS has impacted on our FY21 EBITDAF forecast. However, the medium-term outlook is better and the sizable EBITDAF increases enable modest (+2%-3%) dividend increases in FY22 and FY23. Our target price increase is +NZ\$0.05 (+0.9%) to NZ\$5.55 and MEL continues to trade as the most expensive electricity stock on the market. Our rating is UNDERPERFORM.

NZX Code	MEL	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$7.78	NPAT* (NZ\$m)	510.3	404.0	411.1	425.1	PE	39.0	49.3	48.5	46.9
Target price	NZ\$5.55	EPS* (NZc)	19.9	15.8	16.0	16.6	EV/EBIT	39.5	53.0	49.4	47.7
Risk rating	Low	EPS growth* (%)	5.9	-20.8	1.8	3.4	EV/EBITDA	25.1	30.2	29.1	28.4
Issued shares	2563.0m	DPS (NZc)	19.3	16.9	17.2	17.4	Price / NTA	4.0	4.1	4.3	4.5
Market cap	NZ\$19,927m	Imputation (%)	75	75	75	80	Cash div yld (%)	2.5	2.2	2.2	2.2
Avg daily turnover	1,982k (NZ\$10,754k)	*Based on normalised profits					Gross div yld (%)	3.2	2.8	2.9	2.9

#### What's changed?

- **Earnings (EBITDAF):** FY21 -\$51m (-7%) to NZ\$715m, FY22 +\$72m (+11%) to NZ\$742m, FY23 +\$121m (+19%) to NZ\$759m
- **Dividend:** FY21 unchanged at 16.9cps, FY22 +0.3cps (+2%) to 17.2cps, FY23 +0.5cps (+3%) to 17.4cps
- **Target price:** Increased +NZ\$0.05 (+0.9%) to NZ\$5.55

#### Short-term FY21 downgrade, upside longer term as Manapouri generation continues to have a home

MEL is providing the bulk of the discounted power to NZAS from 14 January 2021 onwards. We estimate the FY21 impact is ~NZ\$38m, with the slightly higher decline due to the dry conditions being experienced in the South Island at present. However, like all of the electricity stocks, we are lifting our medium-term forecasts. The main factors benefitting MEL are the ability to sell all of its Manapouri generation which will no longer be trapped in the lower South Island and higher retail prices.

#### More dividend clarity at 1H21 result, but we do not expect a resumption of special dividends

MEL has indicated it will provide more clarity around its dividend at the 1H21 result in February 2021. It has already ceased its special dividend and we do not expect a resumption of the special dividend. With MEL's ordinary dividend already elevated due to the extraordinary FY20 financial result, there is little scope to increase its dividend, hence our forecast changes in FY22 and beyond, whilst positive, are modest compared to the rest of the sector.

#### Harapaki wind farm development likely to go ahead

Prior to RIO making its shock closure announcement, MEL had been progressing a potential 170MW wind farm development in Hawkes Bay. Given time on the resource consent is running out, high wholesale electricity prices, the benefits it will provide to MEL's retail operations in the North Island and swaption replacement discussions we expect MEL to push go on the project. We assume it will be completed in mid-2023.

## Meridian Energy Limited (MEL)

Priced as at 18 Jan 2021 (NZ\$)

7.78

<b>12-month target price (NZ\$)*</b>	<b>5.55</b>
Expected share price return	-28.7%
Net dividend yield	2.2%
Estimated 12-month return	-26.5%

<b>Spot valuations (NZ\$)</b>	
1. DCF	5.07
2. Market multiple	5.37
3. Dividend yield	5.69

<b>Key WACC assumptions</b>	
Risk free rate	1.30%
Equity beta	0.81
WACC	5.1%
Terminal growth	1.5%

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	14,894
(Net debt)/cash	(1,903)
Less: Capitalised operating leases	
Value of equity	12,991

<b>Profit and Loss Account (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Sales revenue	4,104.0	4,102.0	4,038.0	3,895.7	3,653.1
<b>Normalised EBITDA</b>	<b>838.0</b>	<b>855.0</b>	<b>714.7</b>	<b>741.7</b>	<b>759.4</b>
Depreciation and amortisation	(276.0)	(312.0)	(308.1)	(304.7)	(307.1)
<b>Normalised EBIT</b>	<b>562.0</b>	<b>543.0</b>	<b>406.7</b>	<b>437.0</b>	<b>452.3</b>
Net interest	(83.0)	(84.0)	(79.2)	(80.4)	(89.5)
Associate income & other	(7.0)	(219.0)	(22.0)	(24.0)	(12.0)
Tax	(133.0)	(63.0)	(85.5)	(93.1)	(98.2)
Minority interests	0	0	0	0	0
<b>Reported NPAT</b>	<b>339.0</b>	<b>177.0</b>	<b>219.9</b>	<b>239.5</b>	<b>252.6</b>
Abnormals/other	143.0	333.3	184.1	171.6	172.5
<b>Adjusted normalised NPAT</b>	<b>482.0</b>	<b>510.3</b>	<b>404.0</b>	<b>411.1</b>	<b>425.1</b>
Normalised EPS (cps)	18.8	19.9	15.8	16.0	16.6
DPS (cps)	21.3	19.3	16.9	17.2	17.4

<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
EV/EBITDA (x)	25.5	25.1	30.2	29.1	28.4
EV/EBIT (x)	38.0	39.5	53.0	49.4	47.7
PE (x)	41.4	39.1	49.4	48.5	46.9
Price/NTA (x)	3.7	4.0	4.1	4.3	4.5
Free cash flow yield (%)	2.8	2.7	2.0	1.6	1.1
Net dividend yield (%)	2.7	2.5	2.2	2.2	2.2
Gross dividend yield (%)	3.4	3.2	2.8	2.9	2.9

<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Interest cover EBIT (x)	6.7	3.9	4.9	5.1	4.9
Interest cover EBITDA (x)	10.1	10.2	9.0	9.2	8.5
Net debt/ND+E (%)	76.9	96.6	110.5	125.3	138.4
Net debt/EBITDA (x)	1.7	1.9	2.3	2.4	2.6

<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>
Revenue (%)	24.5	0.0	-1.6	-3.5	-6.2
EBITDA (%)	25.8	2.0	-16.4	3.8	2.4
EBIT (%)	41.2	-3.4	-25.1	7.5	3.5
Normalised NPAT (%)	33.6	5.9	-20.8	1.8	3.4
Normalised EPS (%)	33.6	5.9	-20.8	1.8	3.4
Ordinary DPS (%)	10.9	-9.2	-12.6	1.8	1.4

<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Return on assets (%)	5.7	3.4	4.1	4.5	4.8
Return on equity (%)	6.1	6.3	4.5	4.9	5.5
Return on funds employed (%)	5.9	5.8	4.5	4.9	5.0
EBITDA margin (%)	20.4	20.8	17.7	19.0	20.8
EBIT margin (%)	13.7	13.2	10.1	11.2	12.4
Capex to sales (%)	1.7	1.5	1.9	5.2	8.4
Capex to depreciation (%)	28	22	27	73	108
Imputation (%)	66	75	75	75	80
Pay-out ratio (%)	113	97	107	107	105

<b>Cash Flow (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
<b>EBITDA</b>	<b>838.0</b>	<b>855.0</b>	<b>714.7</b>	<b>741.7</b>	<b>759.4</b>
Working capital change	(36.0)	49.0	(1.4)	17.8	13.3
Interest & tax paid	(200.0)	(251.0)	(208.4)	(217.6)	(229.5)
Other	33.0	(48.0)	(22.0)	(24.0)	(12.0)
<b>Operating cash flow</b>	<b>635.0</b>	<b>605.0</b>	<b>483.0</b>	<b>517.9</b>	<b>531.2</b>
Capital expenditure	(69.0)	(63.0)	(75.4)	(204.4)	(305.4)
Acquisitions/divestments	0	(2.0)	0	0	0
Other	0	0	0	0	0
<b>Funding available/(required)</b>	<b>566.0</b>	<b>540.0</b>	<b>407.5</b>	<b>313.5</b>	<b>225.7</b>
Dividends paid	(500.0)	(546.0)	(433.1)	(440.7)	(447.0)
Equity raised/(returned)	(2.0)	(2.0)	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>64.0</b>	<b>(8.0)</b>	<b>(25.6)</b>	<b>(127.2)</b>	<b>(221.3)</b>

<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Hydro generation	12,326	12,758	11,448	11,701	11,701
Wind generation	1,244	1,466	1,447	1,430	1,500
<b>Total NZ generation (GWh)</b>	<b>13,570</b>	<b>14,224</b>	<b>12,895</b>	<b>13,131</b>	<b>13,200</b>
GWAP (\$/MWh)	123	89	128	119	100
Overseas generation (GWh)	730	642	750	810	810
Overseas GWAP (\$/MWh) (NZD)	269	381	304	315	331
Overseas customer numbers (000)	110	136	149	162	170

<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Working capital	(24.0)	(64.0)	(40.6)	(34.5)	(35.7)
Fixed assets	8,825.0	8,594.0	8,366.0	8,266.8	8,264.8
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	395.0	383.0
<b>Total funds employed</b>	<b>9,243.0</b>	<b>9,036.0</b>	<b>8,804.7</b>	<b>8,686.5</b>	<b>8,671.6</b>
Net debt/(cash)	1,424.0	1,616.0	1,641.6	1,768.7	1,990.1
Lease liability	0	0	0	0	0
Other liabilities	2,362.0	2,337.0	2,293.3	2,249.2	2,207.4
Shareholder's funds	5,457.0	5,083.0	4,869.8	4,668.6	4,474.1
Minority interests	0	0	0	0	0
<b>Total funding sources</b>	<b>9,243.0</b>	<b>9,036.0</b>	<b>8,804.7</b>	<b>8,686.5</b>	<b>8,671.6</b>

NZ electricity customers (000)	302	324	333	333	333
Average usage per cust (MWh/yr)	13.2	13.9	14.3	14.2	14.2
Mass market volumes	3,901	4,342	4,711	4,739	4,743
Time of use volumes	2,338	3,034	3,389	3,406	3,423
<b>Total fixed price volumes (GWh)</b>	<b>6,239</b>	<b>7,376</b>	<b>8,100</b>	<b>8,145</b>	<b>8,166</b>
NZAS sales	5,310	5,431	5,011	5,011	5,011
Sell CFDs	2,239	2,527	2,000	1,600	1,600
Buy CFDs	(1,965)	(2,731)	(3,139)	(2,500)	(2,250)
<b>Total Sales (GWh)</b>	<b>11,823</b>	<b>12,603</b>	<b>11,972</b>	<b>12,255</b>	<b>12,527</b>
Average FPV price (\$/MWh)	105	108	113	115	115
LWAP (\$/MWh)	132	95	138	124	106
LWAP/GWAP	1.07	1.06	1.08	1.05	1.06
Lines losses (%)	5.9	4.8	5.6	5.5	5.5

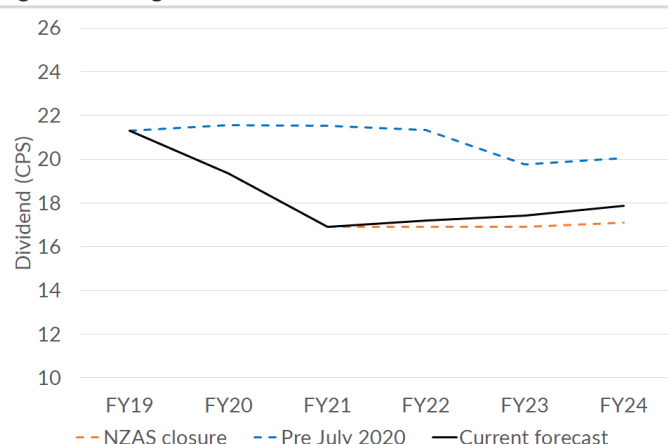
## Summary forecast changes

Figure 1. Summary forecast changes

NZ\$m	FY21			FY22			FY23		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
NZ Energy Margin	1,021	972	-5%	908	976	8%	890	1,001	12%
Australia Energy Margin	110	104	-5%	114	111	-3%	113	112	-1%
<b>EBITDAF</b>	<b>765</b>	<b>715</b>	<b>-7%</b>	<b>670</b>	<b>742</b>	<b>11%</b>	<b>639</b>	<b>759</b>	<b>19%</b>
EBIT	457	407	-11%	366	437	19%	338	452	34%
Pre-tax profit	356	305	-14%	274	333	21%	253	351	39%
<b>NPAT</b>	<b>256</b>	<b>220</b>	<b>-14%</b>	<b>197</b>	<b>239</b>	<b>21%</b>	<b>182</b>	<b>253</b>	<b>39%</b>
Normalised NPAT	256	220	-14%	197	231	17%	182	244	34%
FY dividend (cps)	16.9	16.9	0%	16.9	17.2	2%	16.9	17.4	3%
NZ Generation (GWh)	13,328	12,895	-3%	12,030	13,131	9%	12,543	13,200	5%
FPVV sales (GWh)	8,233	8,100	-2%	9,165	8,145	-11%	9,930	8,166	-18%
Customer numbers (000)	349	333	-5%	380	333	-12%	407	333	-18%
GWAP (\$/MWh)	\$93.1	\$127.6	37%	\$55.0	\$119.0	116%	\$45.1	\$99.8	121%

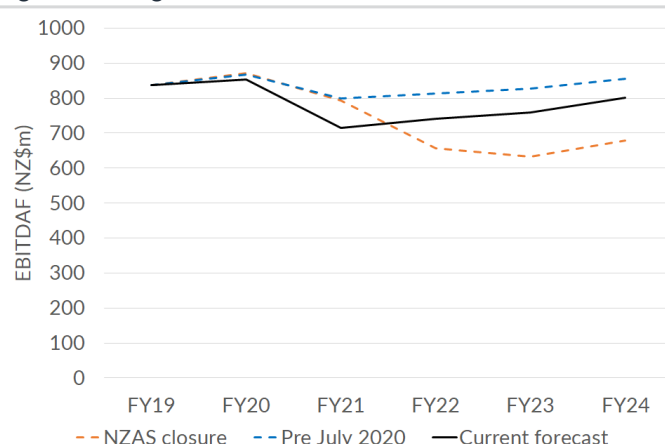
Source: Forsyth Barr analysis

Figure 2. Changes to forecast dividends

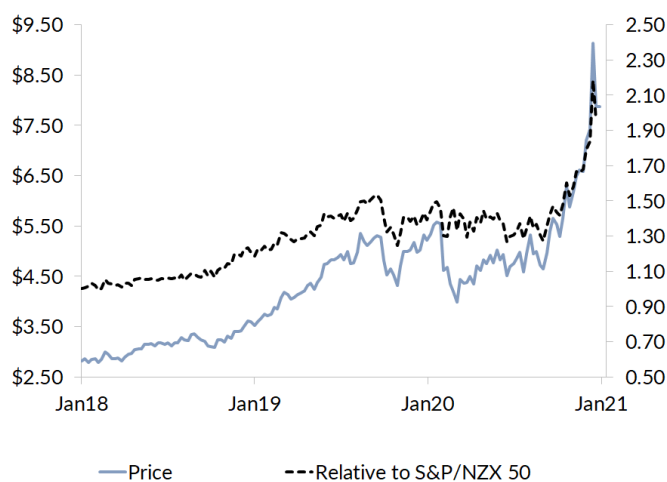


Source: Forsyth Barr analysis

Figure 3. Changes to forecast EBITDAF



Source: Forsyth Barr analysis

**Figure 4. Price performance**


Source: Forsyth Barr analysis

**Figure 5. Substantial shareholders**

Shareholder	Latest Holding
NZ Govt	51.0%
BlackRock Investment Management	6.1%

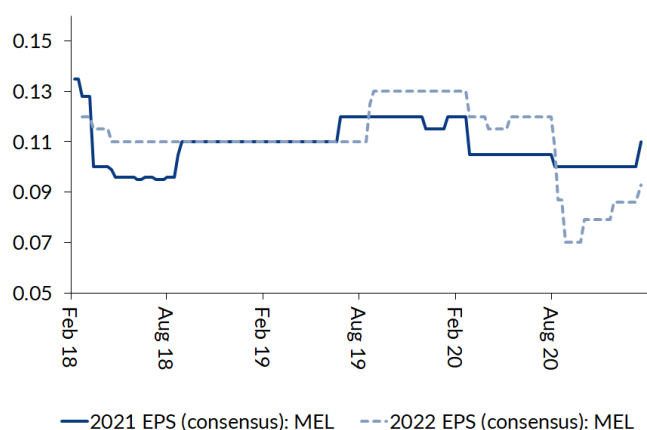
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 6. International valuation comparisons**

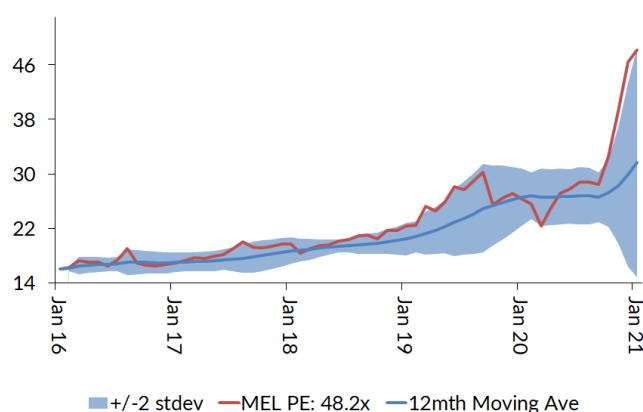
Company	Code	Price	Mkt Cap (m)	PE 2021E 2022E	EV/EBITDA 2021E 2022E	EV/EBIT 2021E 2022E	Cash Yld 2022E
(metrics re-weighted to reflect MEL's balance date - June)							
Meridian Energy	MEL NZ	NZ\$7.78	NZ\$19,927	49.3x 48.5x	30.1x 29.0x	53.0x 49.3x	2.2%
CONTACT ENERGY *	CEN NZ	NZ\$9.55	NZ\$6,862	28.4x 28.5x	17.3x 17.2x	39.1x 35.2x	3.8%
GENESIS ENERGY *	GNE NZ	NZ\$3.70	NZ\$3,861	20.4x 17.6x	12.6x 11.8x	26.6x 24.0x	4.8%
MERCURY *	MCY NZ	NZ\$6.92	NZ\$9,427	34.9x 32.0x	20.7x 18.9x	36.6x 31.9x	2.7%
TRUSTPOWER *	TPW NZ	NZ\$8.78	NZ\$2,748	32.7x 28.6x	17.4x 15.8x	22.7x 20.2x	3.9%
AGL ENERGY	AGLAT	A\$12.00	A\$7,476	13.7x 19.3x	6.0x 7.0x	10.7x 14.6x	5.1%
INFIGEN ENERGY	IFNAT	n/a	n/a	n/a n/a	n/a n/a	n/a n/a	n/a
ORIGIN ENERGY	ORG AT	A\$5.13	A\$9,035	22.5x 15.9x	6.4x 5.8x	23.4x 19.6x	4.8%
Compco Average:				25.4x 23.6x	13.4x 12.7x	26.5x 24.2x	4.2%
MEL Relative:				94% 105%	125% 128%	100% 103%	-47%

EV = Current Market Cap + Actual Net Debt

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

**Figure 7. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 8. One year forward PE (x)**


Source: Forsyth Barr analysis

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