

Meridian Energy

Selling More, Generating Less

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

UNDERPERFORM

Meridian Energy's (MEL) March 2021 operating statistics rounded off its worst quarter since listing, primarily due to low hydro generation and a drop in the NZAS contract price. We estimate that MEL's March 2021 NZ Energy Margin was NZ\$72m, -NZ\$15m lower than March 2020. The 3Q21 NZ Energy Margin of NZ\$195m was below NZ\$200m for the first time since listing, down -26% on 3Q20. With no relief to current hydro conditions in sight, we have trimmed our EBITDAF forecast -NZ\$11m (-2%) to NZ\$690m, and reduced our target price -20cps to NZ\$4.90. UNDERPERFORM.

NZX Code	MEL	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$5.75	NPAT* (NZ\$m)	510.3	383.5	414.8	425.9	PE	28.9	38.4	35.5	34.6
Target price	NZ\$4.90	EPS* (NZc)	19.9	15.0	16.2	16.6	EV/EBIT	29.9	42.7	38.4	37.6
Risk rating	Low	EPS growth* (%)	5.9	-24.9	8.2	2.7	EV/EBITDA	19.0	23.7	22.3	22.0
Issued shares	2563.0m	DPS (NZc)	19.3	16.9	16.9	17.2	Price / NTA	2.9	3.0	3.2	3.3
Market cap	NZ\$14,737m	Imputation (%)	75	85	80	80	Cash div yld (%)	3.4	2.9	2.9	3.0
Avg daily turnover	2,648k (NZ\$15,312k)	*Based on normalised profits					Gross div yld (%)	4.3	3.9	3.9	3.9

What's changed?

- **Earnings:** FY21/FY22/FY23 EBITDAF down -NZ\$11m/-NZ\$8m/-NZ\$13m to NZ\$690/NZ\$733m/NZ\$743m
- **Dividend:** No change to FY21 forecast. FY22/FY23 forecasts trimmed slightly – we expect limited near-term dividend growth
- **Target price:** Reduced -20cps (-4%) to NZ\$4.90

Hydro conditions continue to deteriorate, closing in on calling NZAS to reduce demand

Soft hydro conditions are hampering MEL. In recent years favourable hydro conditions, along with high wholesale electricity prices, have lifted earnings. The lack of low cost generation and the drop in the NZAS price have reduced profitability such that MEL's earnings momentum has turned negative in a meaningful way for the first time since listing. The year to date generation/wholesale performance is down -NZ\$278m vs. last year, only partially offset by +NZ\$92m hedging gains, hence, EBITDAF is tracking -NZ\$136m (-20%) lower than FY20. MEL is close to asking NZAS to reduce its demand, with hydro storage needing to fall ~230GWh before the trigger point is reached, which could take as little as two weeks (but may not be needed at all if it rains).

Retail sales growth continues in March

MEL saw total retail sales growth of +16% in March 2021, with small/medium enterprise (SME) and corporate sales volumes up +27% and +24% respectively. Large business and residential sales volumes fell -2% and -3% respectively. This mix change led to a reduction in the average selling price of -0.7%. During high wholesale electricity periods, growing the retail book is a negative and we expect MEL will be looking closely at its retail strategy.

Generation assumption lowered, retail sales volumes increased, and Australia softness all contribute to weaker forecast

Continued low hydro generation, continued strong retail volume growth and a weak Australia contribution are driving the -NZ\$11m (-2%) reduction in FY21 EBITDAF. We now assume hydro conditions will impact the beginning of FY22, but also assume MEL will dial back recontracting commercial volumes, such that FY22 retail volumes will be lower than FY21. Australia's performance has been impacted by the closing out of renewable energy certificates at a loss. This should be a one-off.

Meridian Energy Limited (MEL)

Priced as at 20 Apr 2021 (NZ\$)

5.75

12-month target price (NZ\$)*	4.90
Expected share price return	-14.8%
Net dividend yield	2.9%
Estimated 12-month return	-11.8%

Spot valuations (NZ\$)	
1. DCF	4.25
2. Market multiple	5.04
3. Dividend yield	5.16

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	0.81
WACC	5.5%
Terminal growth	1.5%

DCF valuation summary (NZ\$m)	
Total firm value	12,689
(Net debt)/cash	(1,801)
Less: Capitalised operating leases	
Value of equity	10,888

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	4,104.0	4,102.0	4,424.8	4,560.5	3,897.1
Normalised EBITDA	838.0	855.0	689.9	732.9	743.4
Depreciation and amortisation	(276.0)	(312.0)	(306.9)	(306.8)	(307.7)
Normalised EBIT	562.0	543.0	383.1	426.1	435.6
Net interest	(83.0)	(84.0)	(80.4)	(77.0)	(83.1)
Associate income & other	(7.0)	(219.0)	77.0	(24.0)	(12.0)
Tax	(133.0)	(63.0)	(106.1)	(91.0)	(95.3)
Minority interests	0	0	0	0	0
Reported NPAT	339.0	177.0	273.6	234.0	245.2
Abnormals/other	143.0	333.3	109.9	180.7	180.8
Adjusted normalised NPAT	482.0	510.3	383.5	414.8	425.9
Normalised EPS (cps)	18.8	19.9	15.0	16.2	16.6
DPS (cps)	21.3	19.3	16.9	16.9	17.2

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	19.3	19.0	23.7	22.3	22.0
EV/EBIT (x)	28.8	29.9	42.7	38.4	37.6
PE (x)	30.6	28.9	38.4	35.5	34.6
Price/NTA (x)	2.7	2.9	3.0	3.2	3.3
Free cash flow yield (%)	3.8	3.7	2.2	2.3	2.1
Net dividend yield (%)	3.7	3.4	2.9	2.9	3.0
Gross dividend yield (%)	4.7	4.3	3.9	3.9	3.9

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	6.7	3.9	5.7	5.2	5.1
Interest cover EBITDA (x)	10.1	10.2	8.6	9.5	8.9
Net debt/ND+E (%)	76.9	96.6	106.7	121.2	136.7
Net debt/EBITDA (x)	1.7	1.9	2.4	2.4	2.5

Growth Rates	2019A	2020A	2021A	2022A	2023A
Revenue (%)	24.5	0.0	7.9	3.1	-14.5
EBITDA (%)	25.8	2.0	-19.3	6.2	1.4
EBIT (%)	41.2	-3.4	-29.5	11.2	2.2
Normalised NPAT (%)	33.6	5.9	-24.9	8.2	2.7
Normalised EPS (%)	33.6	5.9	-24.9	8.2	2.7
Ordinary DPS (%)	10.9	-9.2	-12.6	0.1	1.8

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	5.7	3.4	4.9	4.4	4.7
Return on equity (%)	6.1	6.3	4.1	4.8	5.2
Return on funds employed (%)	5.9	5.8	4.2	4.8	4.9
EBITDA margin (%)	20.4	20.8	15.6	16.1	19.1
EBIT margin (%)	13.7	13.2	8.7	9.3	11.2
Capex to sales (%)	1.7	1.5	2.0	3.4	5.3
Capex to depreciation (%)	28	22	31	54	72
Imputation (%)	66	75	85	80	80
Pay-out ratio (%)	113	97	113	105	104

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	838.0	855.0	689.9	732.9	743.4
Working capital change	(36.0)	49.0	(39.1)	(6.3)	5.1
Interest & tax paid	(200.0)	(251.0)	(252.5)	(212.2)	(222.4)
Other	33.0	(48.0)	10.0	(24.0)	(12.0)
Operating cash flow	635.0	605.0	408.3	490.4	514.1
Capital expenditure	(69.0)	(63.0)	(89.2)	(153.8)	(204.6)
(Acquisitions)/divestments	0	(2.0)	0	0	0
Other	0	0	0	0	0
Funding available/(required)	566.0	540.0	319.1	336.6	309.4
Dividends paid	(500.0)	(546.0)	(433.1)	(433.1)	(441.3)
Equity raised/(returned)	(2.0)	(2.0)	0	0	0
(Increase)/decrease in net debt	64.0	(8.0)	(113.9)	(96.5)	(131.9)

Operating Performance	2019A	2020A	2021E	2022E	2023E
Hydro generation	12,326	12,758	11,221	11,639	11,701
Wind generation	1,244	1,466	1,412	1,428	1,428
Total NZ generation (GWh)	13,570	14,224	12,633	13,067	13,129
GWAP (\$/MWh)	123	89	169	173	122

Overseas generation (GWh)	730	642	753	810	810
Overseas GWAP (\$/MWh) (NZD)	269	381	282	292	302
Overseas customer numbers (000)	110	136	148	161	169

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(24.0)	(64.0)	(74.9)	(44.5)	(37.7)
Fixed assets	8,825.0	8,594.0	8,349.9	8,198.6	8,096.8
Intangibles	59.0	65.0	85.4	83.7	82.4
Right of use asset	0	0	0	0	0
Other assets	383.0	441.0	381.0	357.0	345.0
Total funds employed	9,243.0	9,036.0	8,741.4	8,594.8	8,486.6
Net debt/(cash)	1,424.0	1,616.0	1,626.9	1,723.4	1,855.3
Lease liability	0	0	0	0	0
Other liabilities	2,362.0	2,337.0	2,195.0	2,150.9	2,107.0
Shareholder's funds	5,457.0	5,083.0	4,919.5	4,720.5	4,524.3
Minority interests	0	0	0	0	0
Total funding sources	9,243.0	9,036.0	8,741.4	8,594.8	8,486.6

NZ electricity customers (000)	302	324	333	333	333
Average usage per cust (MWh/yr)	13.2	13.9	14.4	14.2	14.3
Mass market volumes	3,901	4,342	4,714	4,739	4,744
Time of use volumes	2,338	3,034	3,606	3,426	3,443
Total fixed price volumes (GWh)	6,239	7,376	8,320	8,165	8,186
NZAS sales	5,310	5,431	5,011	5,011	5,011
Sell CFDs	2,239	2,527	2,092	1,600	1,600
Buy CFDs	(1,965)	(2,731)	(4,153)	(2,750)	(2,513)
Total Sales (GWh)	11,823	12,603	11,270	12,026	12,285
Average FPV price (\$/MWh)	105	108	110	113	113

LWAP (\$/MWh)	132	95	180	181	129
LWAP/GWAP	1.07	1.06	1.06	1.04	1.06
Lines losses (%)	5.9	4.8	5.1	5.2	5.2

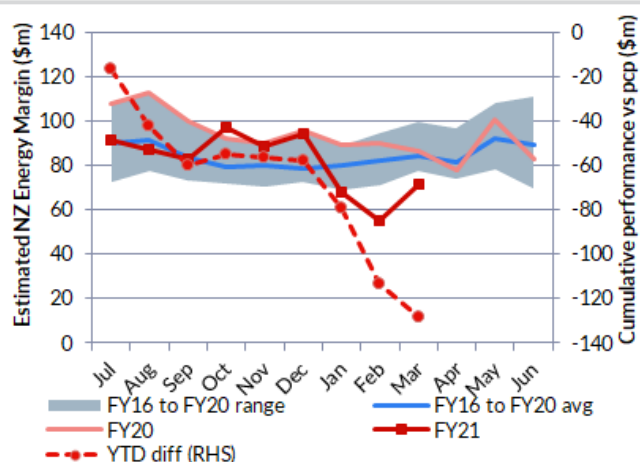
March 2021 and financial year to date operating performance

Figure 1. Estimated EBITDAF breakdown

	Mar-20	Mar-21	Diff	YTD Mar-20	YTD Mar-21	Diff
	\$m	\$m	\$m	\$m	\$m	\$m
NZ retail revenue	124	123	(1)	994	1,051	57
NZ hedging gain/loss (incl mkt costs)	(18)	34	52	9	101	92
NZ generation/wholesale performance	(20)	(86)	(66)	(139)	(416)	(278)
Estimated NZ Energy Margin (NZ\$m)	86	72	(15)	863	735	(128)
AU retail contribution (A\$m)	8	6	(2)	23	55	31
AU hedging gain/loss (incl mkt costs) (A\$m)	(6)	(3)	3	(9)	(17)	(8)
AU generation/wholesale performance (A\$m)	3	2	(1)	78	32	(46)
Estimated AU Energy Margin (A\$m)	6	6	0	92	69	(22)
Operating costs	(21)	(22)	(1)	(188)	(188)	-
Est. transmission costs (NZ & Aus)	(9)	(7)	2	(83)	(66)	16
Est. metering costs	(3)	(3)	(0)	(29)	(30)	(2)
Est. other revenue	2	2	(0)	21	21	(0)
Est MEL EBITDAF (NZ\$m)	61	47	(14)	682	546	(136)

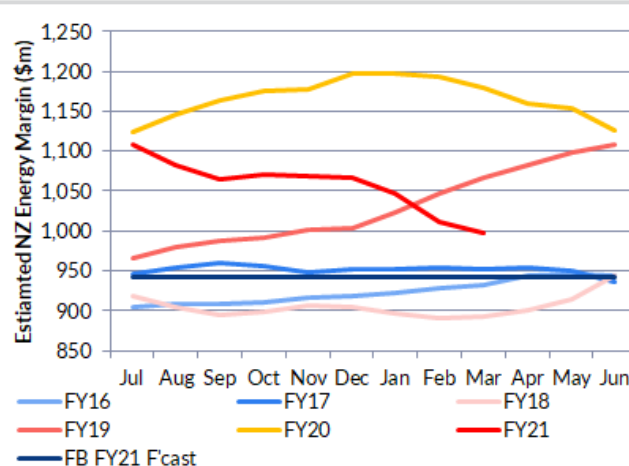
Source: MEL, Forsyth Barr analysis

Figure 2. Historic estimated NZ Energy Margin



Source: MEL, Forsyth Barr analysis

Figure 3. Rolling 12-month estimated Energy Margin



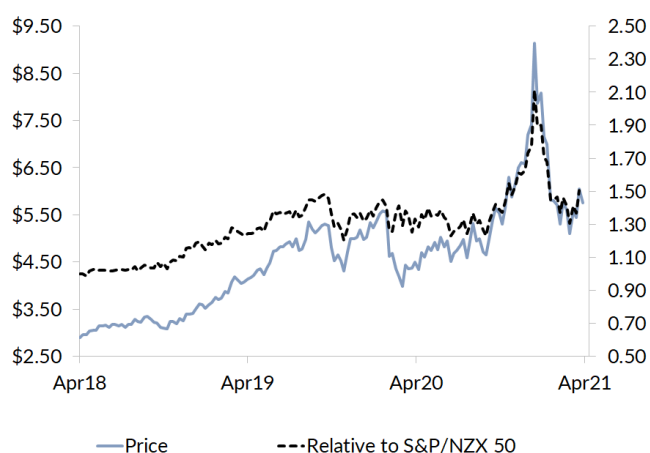
Source: MEL, Forsyth Barr analysis

Summary forecast changes

Figure 4. Summary forecast changes

	FY21	FY21		FY22	FY22		FY23	FY23	
NZ\$m	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
NZ Energy Margin	957	955	0%	988	982	-1%	1,006	996	-1%
Australia Energy Margin	108	99	-8%	110	109	-1%	111	109	-2%
EBITDAF	701	690	-2%	741	733	-1%	756	743	-2%
EBIT	394	383	-3%	434	426	-2%	448	436	-3%
Pre-tax profit	390	380	-3%	332	325	-2%	354	340	-4%
NPAT	281	274	-3%	239	234	-2%	255	245	-4%
Normalised NPAT	211	203	-4%	231	225	-2%	246	237	-4%
FY dividend (cps)	16.9	16.9	0%	17.1	16.9	-1%	17.4	17.2	-1%

Source: Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	51.0%

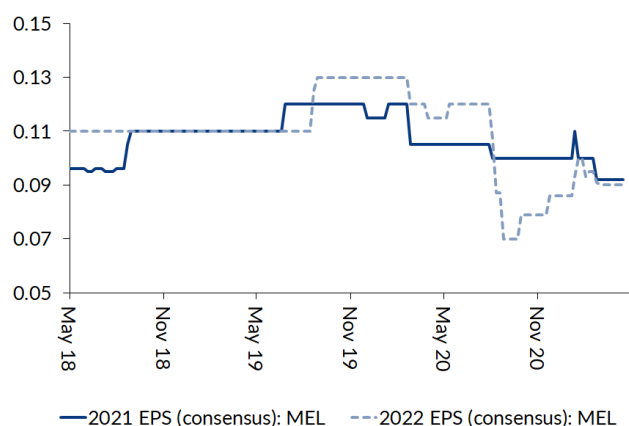
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

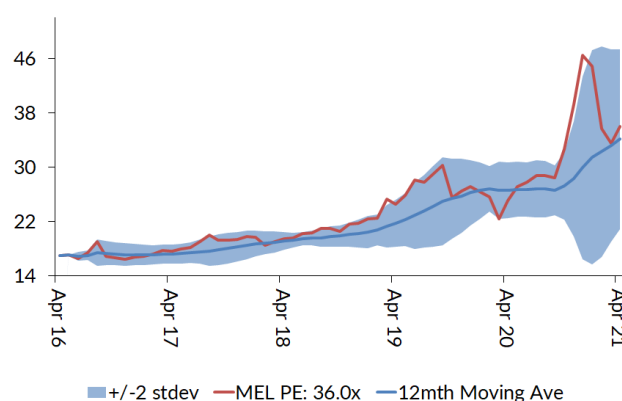
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect MEL's balance date - June)										
Meridian Energy	MEL NZ	NZ\$5.75	NZ\$14,737	38.4x	35.5x	23.7x	22.3x	42.7x	38.4x	2.9%
CONTACT ENERGY *	CEN NZ	NZ\$7.75	NZ\$6,015	21.4x	20.2x	14.2x	13.7x	26.6x	25.0x	4.7%
GENESIS ENERGY *	GNE NZ	NZ\$3.40	NZ\$3,548	17.3x	15.4x	11.6x	11.0x	22.7x	21.2x	5.2%
MERCURY *	MCY NZ	NZ\$6.82	NZ\$9,291	32.0x	26.8x	20.4x	16.5x	34.5x	27.0x	3.2%
TRUSTPOWER *	TPW NZ	NZ\$8.77	NZ\$2,745	32.1x	27.9x	17.2x	15.5x	22.4x	19.8x	3.9%
AGL ENERGY	AGL AT	A\$9.25	A\$5,763	10.9x	16.0x	5.1x	6.0x	9.2x	12.3x	6.1%
ORIGIN ENERGY	ORG AT	A\$4.19	A\$7,379	27.6x	15.0x	6.0x	5.5x	26.8x	20.5x	5.2%
Compco Average:				23.5x	20.2x	12.4x	11.4x	23.7x	21.0x	4.7%
MEL Relative:				63%	76%	91%	96%	80%	83%	-37%

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 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

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