

Trustpower

OUTPERFORM

Mixed Trends — 2Q20 Operating Statistics & 1H20 Result Preview

We expect Trustpower's (TPW) 1H20 EBITDAF result will be down on the pcp, with weak hydro generation volumes being the main issue pulling down the result. TPW's 2Q20 operating statistics were mixed, with retail volumes (electricity and gas) down on the pcp, but telco customer numbers continuing to track upwards. NZAS closure risk has only impacted ASX futures prices slightly, such that we have lifted our wholesale electricity price assumptions, which has had modest positive effect on our medium term forecasts.

What's changed?

- **Earnings:** FY19 EBITDAF up +\$1m, modest increases longer-term
- **Target Price:** Increased +20cps to \$8.20
- **Rating:** OUTPERFORM rating retained

2Q20 operating statistics show continued retail trends

2Q20 saw a continuation of recent trends. Telecommunication customer numbers continue to grow, but whilst electricity customer numbers were flat, mass market and commercial volumes were off -1.2% and -4.6% respectively vs. pcp. Generation volumes were better than 1Q20, but still slightly below average and below the pcp.

Minor changes to forecasts notwithstanding increased NZAS risk

We have made few changes to our forecasts. Our FY20 EBITDAF forecast is up +\$1m to \$210m and there are modest positive changes to our later forecasts (FY21 up +\$2m and FY22 up +\$8m) due to a firmer wholesale electricity price outlook. We note that whilst ASX futures prices have fallen ~-3% following the NZAS strategy review announcement, long-dated ASX futures prices are similar to early-August 2019 and higher than our last TPW earnings forecast update, which was in July. We view lower wholesale electricity prices as the only material risk to TPW from NZAS closing.

We have lifted our target price +20cps to \$8.20 and retain our OUTPERFORM rating.

1H20 result expected to be down on pcp

TPW is reporting its 1H20 result on Thursday 7 November. We are forecasting 1H20 EBITDAF of \$117m, -\$13m lower than the pcp. The main driver of the decline is lower hydro generation volumes (down -15% on the pcp and ~-8% below average). Our 1H20 NPAT forecast of \$56m is -\$9m lower than the pcp. We are forecasting a flat ordinary interim dividend of 17cps (the pcp also included a 25cps special dividend).

Investment View

Our rating is OUTPERFORM. Trustpower (TPW) is a quality business that will generate strong cash flows into the future, enabling an attractive dividend. Whilst TPW does not have the same generation development options as its peers, this will likely ensure shareholders continue to see strong dividends.

NZX Code	TPW
Share price	NZ\$8.21
Target price	NZ\$8.20
Risk rating	Low
Issued shares	313.0m
Market cap	NZ\$2,570m
Average daily turnover	68.0k (NZ\$472k)

Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ\$m)	116.6	105.6	108.6	116.0
EPS* (NZc)	37.1	33.6	34.6	36.9
EPS growth* (%)	-17.3	-9.4	2.9	6.9
DPS (NZc)	74.0	34.0	35.0	36.0
Imputation (%)	55	90	95	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	13.9	15.1	14.8	14.1
EV/EBIT	17.7	19.0	18.5	17.5
PE	22.1	24.4	23.7	22.2
Price / NTA	2.2	2.3	2.3	n/a
Cash dividend yield (%)	9.0	4.1	4.3	4.4
Gross dividend yield (%)	10.9	5.6	5.8	6.1

*Historic and forecast numbers based on underlying profits

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Trustpower Ltd (TPW)

Priced as at 29 Oct 2019: NZ\$8.21

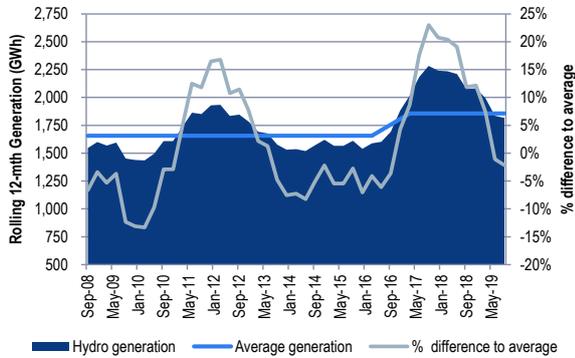
March year end

Forsyth Barr valuation		Valuation Ratios					2018A	2019A	2020E	2021E	2022E
Valuation methodology	Blend of spot valuations, weighted to multiples					EV/EBITDA (x)	11.7	13.9	15.1	14.8	14.1
						EV/EBIT (x)	14.2	17.7	19.0	18.5	17.5
12-month target price (NZ\$)*	8.20	Spot valuations (NZ\$)				PE (x)	18.3	22.1	24.4	23.7	22.2
Expected share price return	-0.1%	1. DCF		8.09		Price/NTA (x)	1.8	2.2	2.3	2.3	2.3
Net dividend yield	4.2%	2. Market multiples		8.16		Free cash flow yield (%)	6.5	3.5	4.0	5.0	5.1
Estimated 12-month return	4.1%	3. Dividend Yield		8.00		Net dividend yield (%)	4.1	4.1	4.1	4.3	4.4
						Gross dividend yield (%)	5.8	5.0	5.6	5.8	6.1
						Imputation (%)	100	55	90	95	100
						Pay-out ratio (%)	76	92	101	101	97
Key WACC assumptions		DCF valuation summary (NZ\$m)									
Risk free rate	2.00%	Total firm value		3,107							
Equity beta	0.88	(Net debt)/cash		(557)							
WACC	6.7%	Value of equity		2,533		Capital Structure	2018A	2019A	2020E	2021E	2022E
Terminal growth	1.5%	Shares (m)		313		Interest cover EBIT (x)	7.0	6.8	5.8	5.8	6.2
						Interest cover EBITDA (x)	7.9	7.9	6.7	6.7	7.1
						Net debt/ND+E (%)	24.8	31.3	34.3	33.6	33.1
						Net debt/EBITDA (x)	1.7	2.5	2.9	2.7	2.5
Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Key Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	979	1,030	1,005	1,023	1,023	Return on assets (%)	9.2	7.2	7.6	8.0	8.6
Normalised EBITDA	270	222	210	216	226	Return on equity (%)	9.9	9.7	9.3	9.6	10.3
Depreciation and amortisation	(47)	(47)	(44)	(43)	(43)	Return on funds employed (%)	8.5	7.2	6.6	7.0	7.5
Normalised EBIT	223	175	166	172	183	EBITDA margin (%)	27.5	21.6	20.9	21.1	22.1
Net interest	(34)	(28)	(31)	(32)	(32)	EBIT margin (%)	22.8	17.0	16.6	16.8	17.9
Depreciation capex adjustment	8	19	16	15	14	Capex to sales (%)	4.2	3.0	2.8	2.8	2.8
Tax	(55)	(48)	(43)	(44)	(47)	Capex to depreciation (%)	134	98	96	98	100
Minority interests	(1)	(2)	(2)	(2)	(2)						
Normalised NPAT	141	117	106	109	116	Divisional Revenue	2018A	2019A	2020E	2021E	2022E
Abnormals/other/depn adj	(13)	(26)	(11)	(11)	(10)	NZ electricity revenue	810	861	840	848	839
Reported NPAT	128	91	94	98	106	Australia electricity revenue	33	-	-	-	-
Normalised EPS (cps)	44.9	37.1	33.6	34.6	36.9	Gas revenue	29	29	29	31	33
DPS (cps)	34.0	34.0	34.0	35.0	36.0	Telecommunication revenue	81	88	94	102	109
						Other revenue	27	52	43	42	42
						Total revenue	979	1,030	1,005	1,023	1,023
Growth Rates	2018A	2019A	2020E	2021E	2022E	Operating Statistics	2018A	2019A	2020E	2021E	2022E
Revenue (%)	4.2	5.2	-2.4	1.8	0.0	NZ generation (GWh)	2,235	1,995	1,815	1,896	1,896
EBITDA (%)	15.0	-17.6	-5.4	2.7	4.9	Australian generation (GWh)	284	-	-	-	-
EBIT (%)	19.3	-21.6	-4.9	3.5	6.2	Total generation (GWh)	2,519	1,995	1,815	1,896	1,896
Normalised NPAT (%)	8.5	-17.3	-9.4	2.9	6.9	NZ GWAP \$/MWh	88	125	119	106	86
Normalised EPS (%)	8.5	-17.3	-9.4	2.9	6.9	Mass market sales (GWh)	1,887	1,845	1,794	1,791	1,782
DPS (%)	3.0	0.0	0.0	2.9	2.9	TOU sales (GWh)	842	880	866	869	872
						Spot sales (GWh)	1,086	1,021	1,034	1,037	1,041
						Total Sales (GWh)	3,815	3,746	3,693	3,696	3,694
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	LWAP \$/MWh	91	131	128	113	93
EBITDA	270	222	210	216	226	LWAP/GWAP	1.04	1.04	1.08	1.07	1.07
Working capital change	25	(47)	(11)	12	9	Electricity customers (000)	273	267	265	264	263
Interest & tax paid	(64)	(75)	(68)	(71)	(75)	Usage/customer (MWh)	6.9	6.8	6.7	6.8	6.8
Other	(23)	20	-	-	-	Revenue/MWh sold (\$)	212	230	227	229	227
Operating cash flow	208	120	131	156	160	Gas customers (000)	37	39	41	42	43
Capital expenditure	(42)	(31)	(28)	(29)	(29)	Volume/customer (GJ)	27.5	26.5	24.5	24.5	24.5
(Acquisitions)/divestments	118	8	-	-	-	Telco customers (000)	87	96	104	111	116
Other	4	(2)	-	-	-	Revenue/customer (\$)	991	963	972	982	992
Funding available/(required)	288	96	103	128	131						
Dividends paid	(110)	(190)	(153)	(106)	(113)						
Equity raised/(returned)	(0)	-	-	-	-						
Increase/(decrease) in net debt	(178)	95	50	(21)	(18)						
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E						
Working capital	(28)	(0)	11	8	11						
Fixed assets	2,102	1,925	1,910	1,896	1,882						
Intangibles	44	37	36	35	35						
Other assets	60	115	115	106	94						
Total funds employed	2,178	2,076	2,072	2,045	2,022						
Net debt/(cash)	467	557	608	587	569						
Other non current liabilities	276	270	272	273	273						
Shareholder's funds	1,413	1,224	1,165	1,157	1,150						
Minority interests	22	25	27	29	31						
Total funding sources	2,178	2,076	2,072	2,045	2,022						

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

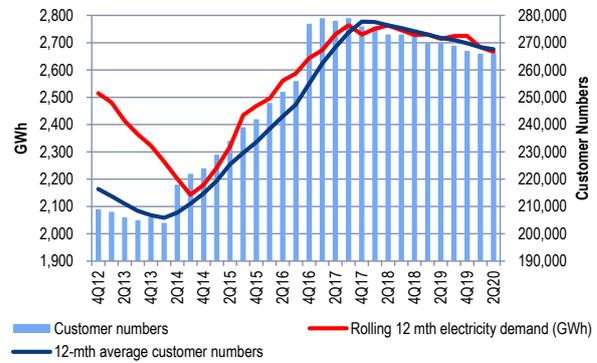
2Q20 operating statistics

Figure 1. Rolling 12-month hydro generation vs. average



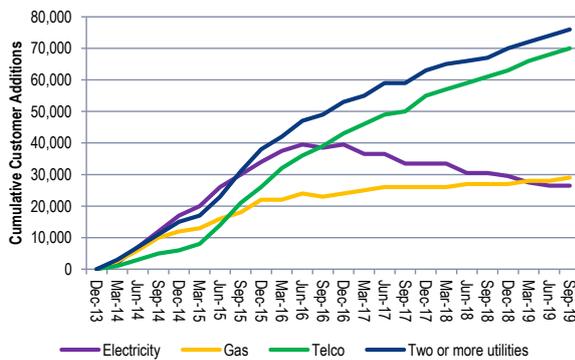
Source: TPW, Forsyth Barr analysis

Figure 2. Electricity sales volumes vs. connection numbers



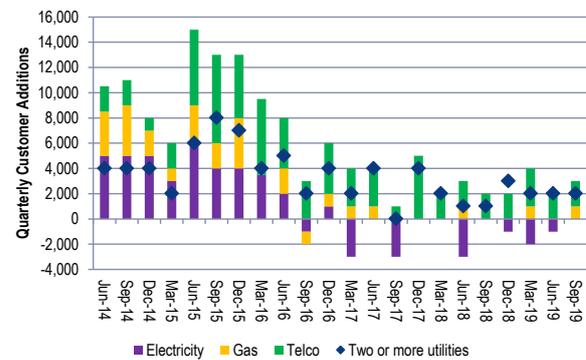
Source: TPW, Forsyth Barr analysis

Figure 3. Connection changes since launch of triple-play strategy



Source: TPW, Forsyth Barr analysis

Figure 4. Quarterly connections changes



Source: TPW, Forsyth Barr analysis

Summary forecast changes

Figure 5. Summary forecast changes

	FY20			FY21			FY22		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
	\$m	\$m	%	\$m	\$m	%	\$m	\$m	%
Revenue	997	1,005	0.9%	1,015	1,023	0.8%	1,029	1,023	-0.6%
EBITDAF	209	210	0.4%	214	216	0.7%	218	226	3.8%
EBIT	166	166	0.5%	171	172	0.9%	175	183	4.7%
NPAT	96	96	0.5%	99	100	1.1%	102	108	6.0%
Normalised Profit	94	94	0.5%	97	98	1.1%	100	106	6.2%
DPS	34.0	34.0	0.0%	35.0	35.0	0.0%	36.0	36.0	0.0%
Generation volumes (GWh)	1,801	1,815	0.8%	1,896	1,896	0.0%	1,896	1,896	0.0%
Electricity wholesale price (\$/MWh)	\$94.3	\$122.5	29.9%	\$89.7	\$92.2	2.8%	\$84.2	\$89.1	5.8%
Retail sales (GWh)	2,724	2,660	-2.4%	2,722	2,659	-2.3%	2,717	2,653	-2.3%

Source: TPW, Forsyth Barr analysis

1H20 result forecast

Figure 6. 1H20 result forecast

6 Mths Ending Sept (\$m)	1H19	1H20F	Change
Electricity	433	454	5%
Other	80	84	5%
Total Revenue	512	538	5%
Costs	(383)	(420)	10%
EBITDAF	130	118	-9%
Depreciation and amortisation	(25)	(22)	-12%
EBIT	105	96	-9%
Fair value gains/(losses)	(1)	0	
Net interest	(13)	(15)	11%
Pretax Profit	90	81	-10%
Tax	(25)	(23)	-8%
REPORTED PROFIT	65	58	-11%
Minority interests	(1)	(1)	
Profit Attributable to Shareholders	64	57	-11%
Abnormal items	1	0	
NORM PROFIT	65	57	-12%
Earnings per share (cps)	20.7	18.1	-12%
Ordinary dividend per share (cps)	17.0	17.0	0%
NZ generation (GWh)	1,167	989	-15%
FPVV electricity sold (GWh)	1,501	1,443	-4%

Source: TPW, Forsyth Barr analysis

Investment summary

Our rating is **OUTPERFORM**. Trustpower (TPW) is a quality business that will generate strong cash flows into the future, enabling an attractive dividend. Whilst TPW does not have the same generation development options as its peers, this will likely ensure shareholders continue to see strong dividends.

Business quality

- **Low risk, modest growth industry:** Electricity demand is relatively inelastic and is expected to grow slowly in the future. The industry is well positioned to benefit from New Zealand decarbonising transport and industrial processes.
- **Diversified generation position:** Most of the value within the electricity sector lies within the generation assets. TPW has several small scale hydro generators positioned around New Zealand, creating hydro diversification.
- **Track record:** TPW has focussed on developing a bundled retail strategy, offering telco products alongside its energy products. Whilst retail earnings growth is modest, TPW is reducing churn and the telco product is driving most of its retail earnings growth.

Earnings and cash flow outlook

- **Earnings growth modest and linked to margin growth:** TPW's future earnings growth is modest as it has no large-scale development projects planned in the near-term.
- **Operating cash flow strong but growth likely to be slow:** TPW has a strong track record of returning surplus cash to shareholders. Whilst there is unlikely to be strong ordinary dividend growth, we expect TPW to continue to pay fully imputed dividends.

Company description

TPW is the smallest of the major electricity generator / retailers. It retails electricity to ~270,000 customers, gas to ~38,000 customers and telecommunication services to ~91,000 customers. TPW's bundled retail offering is unique amongst the large electricity retailers. TPW owns 36 small to medium sized hydro generation schemes, spread across both the North and South Island. TPW also owns 80% of generator King Country Energy (KCE).

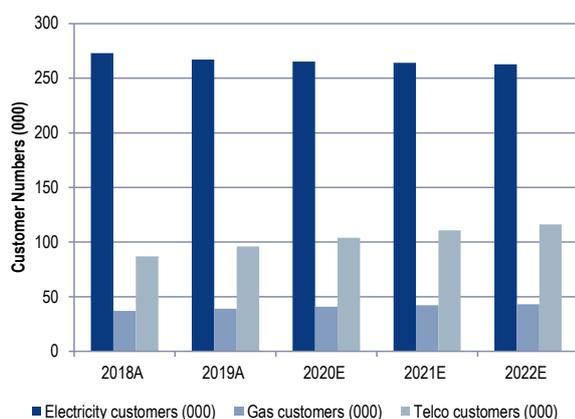
Financial structure

- **Balance sheet:** Following two substantial special dividends paid in FY19, balance sheet headroom is limited, although in our view the balance sheet is not stretched. TPW has no near-term material investments planned.

Key risks

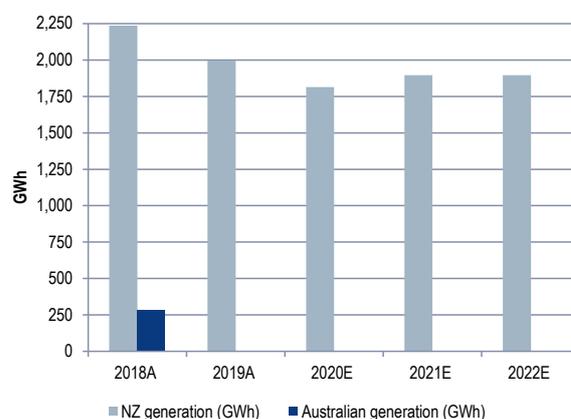
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance) and TPW will be among the least affected if it does.
- **Rising bond yields:** In recent years TPW has traded in line with bond yields. A lift in interest rates is likely to see TPW trade lower, although in our view interest rates are likely to remain low for the foreseeable future.

Figure 7. Connection numbers



Source: TPW, Forsyth Barr analysis

Figure 8. Generation volumes



Source: TPW, Forsyth Barr analysis

Figure 9. Substantial Shareholders

Shareholder	Latest Holding
Infratil	51.0%
TECT Holdings	26.8%

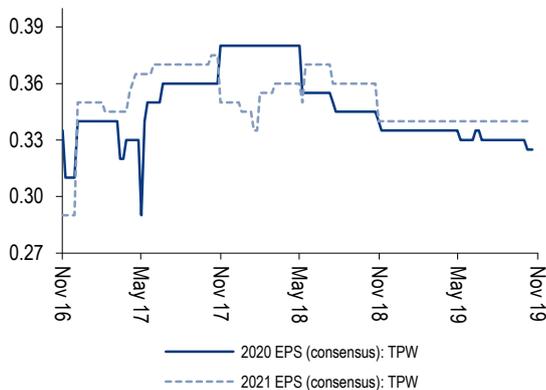
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 10. International Compcos

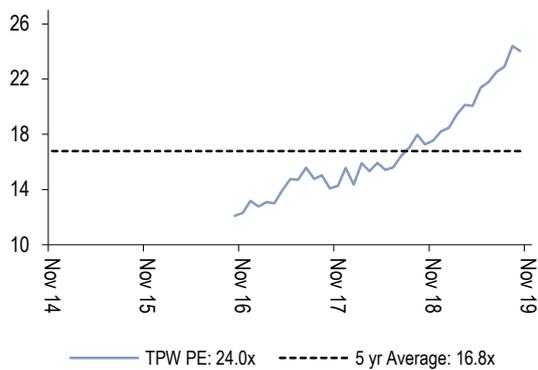
Company <i>(metrics re-weighted to reflect TPW's balance date - March)</i>	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld	
				2020E	2021E	2020E	2021E	2020E	2021E	2020E	2021E
Trustpower	TPW NZ	NZ\$8.21	NZ\$2,570	24.4x	23.7x	14.9x	14.5x	18.8x	18.1x	4.3%	
Contact Energy *	CEN NZ	NZ\$7.67	NZ\$5,505	21.4x	21.1x	13.5x	13.3x	23.4x	22.7x	5.1%	
Genesis Energy *	GNE NZ	NZ\$3.20	NZ\$3,276	20.8x	17.8x	12.2x	11.3x	28.1x	24.5x	5.5%	
Meridian Energy *	MEL NZ	NZ\$4.81	NZ\$12,328	25.7x	27.4x	16.7x	17.6x	26.3x	28.8x	4.5%	
Mercury *	MCY NZ	NZ\$5.05	NZ\$6,880	28.1x	25.6x	15.6x	15.2x	25.7x	24.9x	3.2%	
AGL Energy	AGL AT	A\$19.71	A\$12,792	15.0x	15.3x	7.4x	7.3x	11.2x	11.4x	5.0%	
ERM Power	EPW AT	A\$2.41	A\$603	10.3x	15.1x	6.1x	6.8x	8.5x	9.6x	4.3%	
Origin Energy	ORG AT	A\$7.99	A\$14,072	13.1x	13.1x	8.5x	6.1x	16.8x	14.7x	4.4%	
Compcos Average:				19.2x	19.3x	11.4x	11.1x	20.0x	19.5x	4.6%	
TPW Relative:				+27%	+23%	+30%	+31%	-6%	-7%	-7%	

EV = Current Market Cap + Actual Net Debt

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

Figure 11. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 12. 12 Month Forward PE


Source: Forsyth Barr analysis

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