FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | UTILITIES | ELECTRICITY GENERATOR/RETAILER
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Trustpower
Dry Start to 2020

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OUTPERFORM

Whilst Trustpower (TPW) downgraded its FY20 EBITDAF guidance ~-$17.5m (-8%) in February, and February generation was weak, we have upgraded our rating to OUTPERFORM due to an excessive fall in its share price. TPW is now trading on close to sector low multiples and offers investors a stable dividend with a gross dividend yield above 7.0%

NZX Code	TPW
Share price	NZ$6.60
Target price	NZ$7.70
Risk rating	Low
Issued shares	313.0m
Market cap	NZ$2,066m
Avg daily turnover	67.3k (NZ$484k)

Financials: Mar/	19A	20E	21E	22E
NPAT* (NZ$m)	116.6	84.4	100.9	107.3
EPS* (NZc)	37.1	26.9	32.1	34.2
EPS growth* (%)	-17.3	-27.6	19.5	6.3
DPS (NZc)	74.0	34.0	34.0	35.0
Imputation (%)	55	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	11.7	14.3	13.2	12.6
EV/EBIT	14.8	18.2	16.3	15.4
PE	17.8	24.6	20.5	19.3
Price / NTA	1.7	1.9	1.9	1.9
Cash div yld (%)	11.2	5.2	5.2	5.3
Gross div yld (%)	13.6	7.2	7.2	7.4

FY20 ending with a whimper, following record low February 2020 hydro generation

TPW is experiencing a tough finish to FY20. We estimate February 2020 hydro generation was 69GWh, the lowest February generation in more than a decade and represents a market share of just 2.2%. This is lower than the ~95GWh TPW indicated it expected in its earnings downgrade. In addition, wholesale electricity prices have tracked lower than TPW had been expecting.

We have dropped our FY20 EBITDAF forecast -$16m (-8%) to $187m. This is towards the bottom end of TPW's revised $185m to $195m guidance range (which is down from the old $200m to $215m guidance range). TPW also cited lower gas margins as an issue, although that is largely offset by better than expected telco and electricity margins. We have lowered our target price -5cps to $7.70 in light of the weaker short-term outlook.

Figure 1. Summary forecast changes

$m	FY20 Old	FY20 New	% Chg	FY21 Old	FY21 New	% Chg	FY22 Old	FY22 New	% Chg
Revenue	1,000	982	-1.8%	994	988	-0.6%	994	994	0.1%
EBITDAF	**203**	**187**	**-7.7%**	**209**	**207**	**-0.9%**	**220**	**217**	**-1.0%**
EBIT	161	146	-9.7%	169	168	-1.1%	179	177	-1.2%
NPAT	**80**	**69**	**-14.2%**	**96**	**94**	**-1.8%**	**103**	**101**	**-2.1%**
Normalised Profit	89	78	-12.8%	94	93	-1.8%	101	99	-2.2%
DPS	34.0	34.0	0.0%	34.0	34.0	0.0%	35.0	35.0	0.0%
Generation volumes (GWh)	1,815	1,753	-3.4%	1,896	1,896	0.0%	1,896	1,896	0.0%
Electricity Wholesale Price ($/MWh)	$107.6	$99.7	-7.3%	$88.1	$94.7	7.4%	$91.2	$88.0	-3.5%
Retail sales (GWh)	2,660	2,660	0.0%	2,659	2,659	0.0%	2,653	2,653	0.0%

Source: Forsyth Barr analysis

Rating upgrade to OUTPERFORM

In the past four weeks, TPW's share price has fallen -15%. Whilst the earnings downgrade is not helpful, most of it related to hydrological/wholesale market conditions and therefore cannot be expected to continue. Our rating upgrade reflects the fact TPW is now trading on relatively low market multiples and is offering good value in a sector with stable earnings and a positive outlook.

Trustpower Ltd (TPW)

Priced as at 04 Mar 2020 (NZ$)	**6.60**

12-month target price (NZ$)*	**7.70**
Expected share price return	16.7%
Net dividend yield	5.2%
Estimated 12-month return	21.8%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.88
WACC	6.7%
Terminal growth	1.5%

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	979.4	1,030.1	982.3	988.4	994.5
Normalised EBITDA	**269.8**	**222.2**	**187.4**	**207.4**	**217.4**
Depreciation and amortisation	(15.8)	(47.2)	(39.5)	(39.8)	(40.3)
Normalised EBIT	**223**	**175**	**148**	**168**	**177**
Net interest	(34)	(28)	(35)	(35)	(36)
Depreciation capex adjustment	8	19	9	11	11
Tax	(55)	(48)	(35)	(41)	(44)
Minority interests	(1)	(2)	(2)	(2)	(2)
Normalised NPAT	**141**	**117**	**84**	**101**	**107**
Abnormals/other/depn adj	(13)	(26)	(17)	(8)	(8)
Reported NPAT	**128**	**91**	**67**	**93**	**99**
Normalised EPS (cps)	44.9	37.1	26.9	32.1	34.2
DPS (cps)	34.0	74.0	34.0	34.0	35.0

Growth Rates	**2018A**	**2019A**	**2020A**	**2021A**	**2022A**
Revenue (%)	4.2	5.2	-4.6	0.6	0.6
EBITDA (%)	15.0	-17.6	-15.7	10.7	4.8
EBIT (%)	19.3	-21.6	-15.5	13.3	5.6
Normalised NPAT (%)	8.5	-17.3	-27.6	19.5	6.3
Normalised EPS (%)	8.5	-17.3	-27.6	19.5	6.3
Ordinary DPS (%)	3.0	0.0	0.0	0.0	2.9

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**269.8**	**222.2**	**187.4**	**207.4**	**217.4**
Working capital change	24.6	(47.1)	(37.5)	0.2	8.1
Interest & tax paid	(63.8)	(74.8)	(79.1)	(72.5)	(76.4)
Other	(22.8)	20.0	20.4	0	0
Operating cash flow	**207.7**	**120.3**	**91.2**	**135.1**	**149.1**
Capital expenditure	(41.5)	(31.1)	(30.5)	(28.4)	(29.0)
(Acquisitions)/divestments	118.2	8.1	0	0	0
Other	3.9	(1.7)	0	0	0
Funding available/(required)	**288.2**	**95.6**	**60.6**	**106.7**	**120.1**
Dividends paid	(110.2)	(190.4)	(153.7)	(106.4)	(108.0)
Equity raised/(returned)	(0.5)	0	0	0	0
(Increase)/decrease in net debt	**177.6**	**(94.8)**	**(93.0)**	**0.3**	**12.1**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	(28.3)	(0.3)	20.5	23.0	24.6
Fixed assets	2,102.2	1,924.7	1,913.0	1,898.6	1,884.2
Intangibles	44.1	37.0	40.1	43.2	46.2
Right of use asset	0	0	0	0	0
Other assets	59.6	114.8	173.1	170.4	160.8
Total funds employed	**2,177.6**	**2,076.2**	**2,146.7**	**2,135.2**	**2,115.8**
Net debt/(cash)	466.7	557.4	653.7	653.4	641.3
Lease liability	0	0	0	0	0
Other liabilities	275.9	269.8	314.1	314.9	314.9
Shareholder's funds	1,412.9	1,224.4	1,153.9	1,140.2	1,131.3
Minority interests	22.0	24.6	25.0	26.6	28.3
Total funding sources	**2,177.6**	**2,076.2**	**2,146.7**	**2,135.2**	**2,115.8**

Spot valuations (NZ$)	
1. DCF	7.27
2. Market multiples	7.48
3. Dividend Yield	7.92

DCF valuation summary (NZ$m)	
Total firm value	2,947
(Net debt)/cash	(634)
Less: Capitalised operating leases	
Value of equity	2,297

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	9.8	11.7	14.3	13.2	12.6
EV/EBIT (x)	11.9	14.8	18.2	16.3	15.4
PE (x)	14.7	17.8	24.6	20.5	19.3
Price/NTA (x)	1.5	1.7	1.9	1.9	1.9
Free cash flow yield (%)	8.0	4.3	2.9	5.2	5.8
Net dividend yield (%)	5.2	11.2	5.2	5.2	5.3
Gross dividend yield (%)	7.2	13.6	7.2	7.2	7.4

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	7.0	6.8	4.5	5.0	5.2
Interest cover EBITDA (x)	7.9	7.9	5.4	5.9	6.0
Net debt/ND+E (%)	48.9	58.6	68.0	69.0	69.2
Net debt/EBITDA (x)	1.7	2.5	3.5	3.2	2.9

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	9.2	7.2	5.9	7.5	8.0
Return on equity (%)	9.9	9.7	7.6	9.2	9.9
Return on funds employed (%)	8.5	7.2	5.9	6.6	7.0
EBITDA margin (%)	27.5	21.6	19.1	21.0	21.9
EBIT margin (%)	22.8	17.0	15.1	17.0	17.8
Capex to sales (%)	4.2	3.0	3.1	2.9	2.9
Capex to depreciation (%)	n/a	98	104	97	99
Imputation (%)	100	55	100	100	100
Pay-out ratio (%)	76	199	126	106	102

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
NZ electricity revenue	810	861	810	816	814
Gas revenue	29	29	30	32	34
Telecommunication revenue	81	88	92	96	103
Other revenue	60	52	50	45	44
Total revenue	**979**	**1,030**	**982**	**988**	**994**
Generation (GWh)	2,235	1,995	1,753	1,896	1,896
NZ GWAP ($/MWh)	88	125	104	100	87
Mass market sales (GWh)	1,887	1,845	1,794	1,791	1,782
TOU sales (GWh)	842	880	866	869	872
Spot sales (GWh)	1,086	1,021	1,034	1,037	1,041
Total Sales (GWh)	**3,815**	**3,746**	**3,693**	**3,696**	**3,694**
LWAP ($/MWh)	91	131	108	108	93
LWAP/GWAP	1.04	1.04	1.04	1.07	1.07
Electricity customers (000)	273	267	265	264	263
Usage/customer (MWh)	6.9	6.8	6.7	6.8	6.8
Revenue/MWh sold ($)	212	230	219	221	220
Gas customers (000)	37	39	41	42	43
Volume/customer (GJ)	27.5	26.5	24.5	24.5	24.5
Telco customers (000)	87	96	104	111	116
Revenue/customer ($)	991	963	959	968	978

Investment Summary

Our rating is OUTPERFORM. TPW is trading on undemanding multiples and offers investors an attractive dividend in a sector with stable earnings. The long-term outlook for the sector is positive as New Zealand looks to de-carbonise which will result in higher electricity use.

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 cashflow 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.

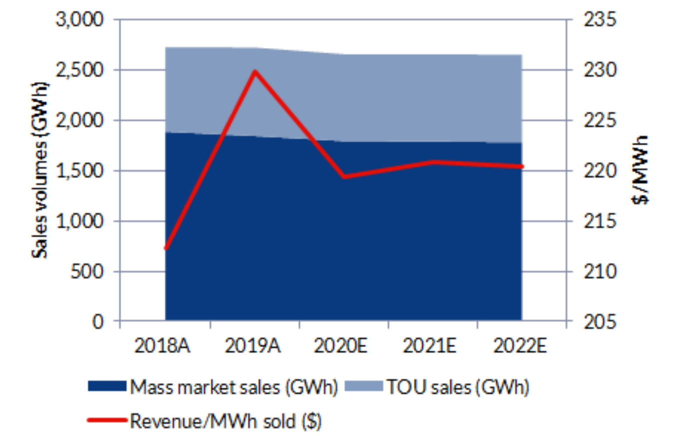
Financial structure

- **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.

Risk factors

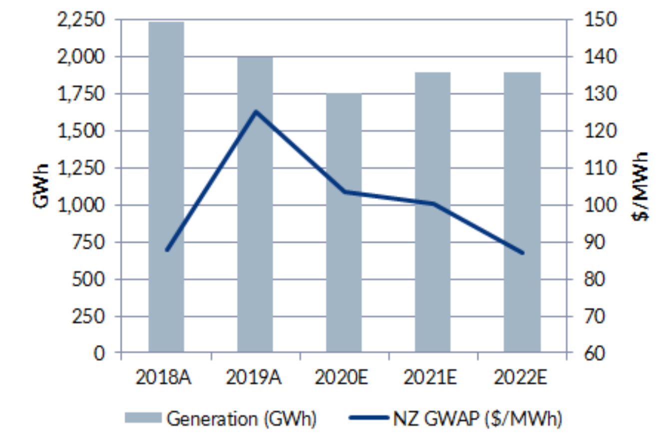
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance) and TPW will be among the least affected if it does.
- **Rising bond yields:** In recent years TPW has traded in line with 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 2. Retail sales volumes and average price received



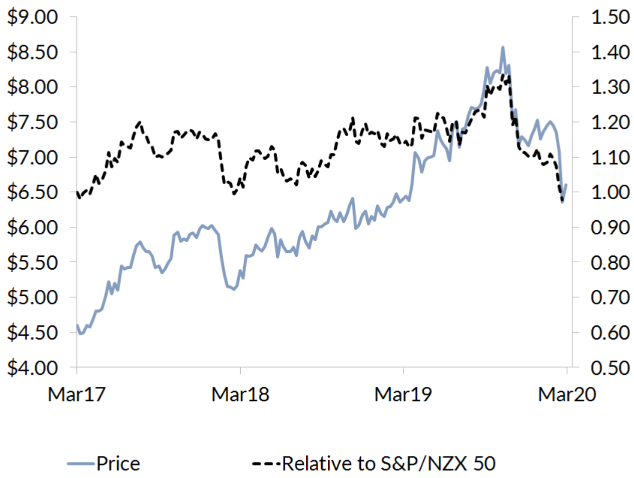
Source: TPW, Forsyth Barr analysis

Figure 3. Generation volumes and average price received



Source: TPW, Forsyth Barr analysis

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Infratil	51.0%
TECT Holdings	26.8%

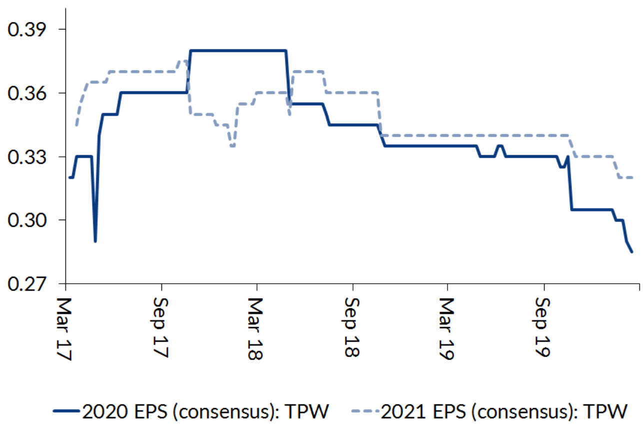
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect TPW's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Trustpower	**TPW NZ**	**NZ$6.60**	**NZ$2,066**	**24.6x**	**20.5x**	**14.0x**	**12.6x**	**17.7x**	**15.6x**	**5.2%**
Contact Energy *	CEN NZ	NZ$6.59	NZ$4,732	19.5x	19.3x	12.3x	12.2x	23.3x	23.6x	5.9%
Genesis Energy *	GNE NZ	NZ$3.07	NZ$3,160	19.3x	17.0x	12.0x	11.2x	30.0x	27.3x	5.7%
Meridian Energy *	MEL NZ	NZ$4.81	NZ$12,328	24.9x	26.7x	16.0x	16.8x	24.9x	27.0x	4.5%
Mercury *	MCY NZ	NZ$4.65	NZ$6,335	26.8x	24.1x	14.8x	14.3x	24.9x	23.9x	3.5%
AGL ENERGY	AGL AT	A$18.86	A$12,052	14.1x	14.3x	7.1x	7.0x	10.8x	10.9x	5.3%
ORIGIN ENERGY	ORG AT	A$7.04	A$12,399	11.6x	12.4x	7.9x	5.9x	15.7x	14.6x	4.9%
			Compco Average:	**19.4x**	**19.0x**	**11.7x**	**11.2x**	**21.6x**	**21.2x**	**5.0%**
EV = Current Market Cap + Actual Net Debt			**TPW Relative:**	**27%**	**8%**	**20%**	**13%**	**-18%**	**-26%**	**4%**

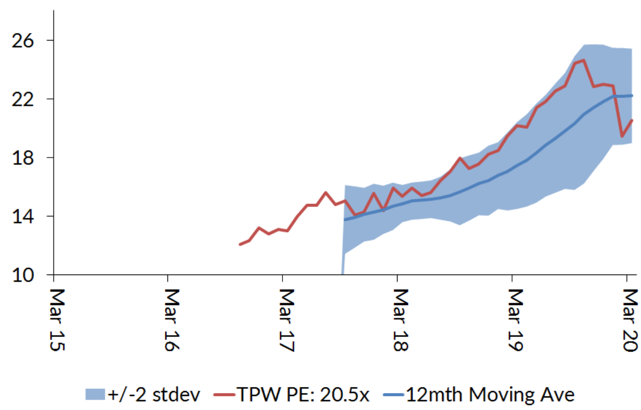
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TPW) companies fiscal year end

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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OUTPERFORM	NEUTRAL	UNDERPERFORM
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