

# Trustpower

## Adjusting Assumptions

**ANDREW HARVEY-GREEN**

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

**SCOTT ANDERSON**

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

### NEUTRAL

Our Trustpower (TPW) target price has increased +NZ\$1.23/share to NZ\$7.78/share due to two factors. With the electricity futures market increasingly confident that NZAS will remain open beyond August 2021 we have partially lifted our target price to allow for the probability NZAS will remain open. In addition we have taken the opportunity to adjust our valuation (and target price) for recent cost of capital assumption changes that has lowered TPW's WACC.

NZX Code	TPW	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$7.27	NPAT* (NZ\$m)	74.2	89.2	92.0	87.2	PE	30.8	25.6	24.8	26.2
Target price	NZ\$7.78	EPS* (NZc)	23.6	28.4	29.3	27.8	EV/EBIT	20.0	20.1	19.6	20.5
Risk rating	Low	EPS growth* (%)	-36.4	20.3	3.2	-5.3	EV/EBITDA	15.4	15.1	14.9	15.4
Issued shares	313.0m	DPS (NZc)	32.5	30.5	30.0	30.0	Price / NTA	2.1	2.2	2.2	2.2
Market cap	NZ\$2,275m	Imputation (%)	100	100	100	100	Cash div yld (%)	4.5	4.2	4.1	4.1
Avg daily turnover	46.4k (NZ\$325k)	*Based on normalised profits					Gross div yld (%)	6.2	5.8	5.7	5.7

### Significant target price change following cost of capital assumption changes

We have lifted our TPW target price +NZ\$1.23 to NZ\$7.78/share. The main driver of the uplift (+NZ\$1.00/share) has been the incorporation of a lower cost of capital assumption which has resulted in TPW's cost of capital falling -1.3% to 5.4%. Our DCF valuation has increased +27% to NZ\$7.65/share as a result. TPW is the last of the electricity companies to reflect revised cost of capital assumptions.

The second factor lifting our target price is the incorporation of upside associated with NZAS remaining open beyond August 2021. The electricity futures market is increasingly confident NZAS will remain open (75% to 85% chance in FY22 and 50% to 60% chance in FY23). Relative to expectations if NZAS closes, we estimate that TPW can increase its dividend +2cps to 32cps. Allowing for that possible upside has added +23cps to our target price.

### Modest forecast changes ahead of 1H21 result

Whilst 1H21 has been another challenging period for TPW due to low hydro generation volumes, it has been aided by firm wholesale electricity prices and good wind volumes (purchased from Tilt Renewables). Our FY21 forecast changes are therefore relatively modest, with our FY21 EBITDAF forecast increased +NZ\$2m to NZ\$192m.

TPW is reporting its 1H21 result on Thursday 5 November. However, we're not expecting many fireworks and our 1H21 EBITDAF forecast is NZ\$109m, +NZ\$2m on 1H20.

## Trustpower Ltd (TPW)

Priced as at 06 Oct 2020 (NZ\$)

7.27

<b>12-month target price (NZ\$)*</b>	<b>7.78</b>
Expected share price return	7.0%
Net dividend yield	4.2%
Estimated 12-month return	11.2%

<b>Spot valuations (NZ\$)</b>	
1. DCF	7.65
2. Market multiples	7.15
3. Dividend Yield	7.44

<b>Key WACC assumptions</b>	
Risk free rate	1.30%
Equity beta	0.84
WACC	5.4%
Terminal growth	1.5%

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	3,076
(Net debt)/cash	(665)
Less: Capitalised operating leases	
Value of equity	2,395

<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	1,030.1	989.9	946.6	920.7	906.2
<b>Normalised EBITDA</b>	<b>222.2</b>	<b>186.5</b>	<b>192.0</b>	<b>195.3</b>	<b>188.7</b>
Depreciation and amortisation	(47.2)	(42.6)	(47.2)	(47.1)	(47.1)
<b>Normalised EBIT</b>	<b>175</b>	<b>144</b>	<b>145</b>	<b>148</b>	<b>142</b>
Net interest	(28)	(32)	(26)	(25)	(24)
Depreciation capex adjustment	19	(2)	9	8	7
Tax	(45)	(32)	(36)	(37)	(35)
Minority interests	(2)	(3)	(3)	(3)	(3)
<b>Normalised NPAT</b>	<b>117</b>	<b>74</b>	<b>89</b>	<b>92</b>	<b>87</b>
Abnormals/other/depn adj	(26)	21	(6)	(6)	(5)
<b>Reported NPAT</b>	<b>91</b>	<b>95</b>	<b>83</b>	<b>86</b>	<b>82</b>
Normalised EPS (cps)	37.1	23.6	28.4	29.3	27.8
DPS (cps)	74.0	32.5	30.5	30.0	30.0

<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
EV/EBITDA (x)	12.6	15.4	15.1	14.9	15.4
EV/EBIT (x)	16.0	20.0	20.1	19.6	20.5
PE (x)	19.6	30.8	25.6	24.8	26.2
Price/NTA (x)	1.9	2.1	2.2	2.2	2.2
Free cash flow yield (%)	3.9	3.4	4.7	4.8	4.7
Net dividend yield (%)	10.2	4.5	4.2	4.1	4.1
Gross dividend yield (%)	12.4	6.2	5.8	5.7	5.7

<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Interest cover EBIT (x)	6.8	4.9	6.1	6.6	6.5
Interest cover EBITDA (x)	7.9	5.9	7.4	8.0	7.9
Net debt/ND+E (%)	58.6	64.8	65.6	65.8	66.4
Net debt/EBITDA (x)	2.5	3.3	3.2	3.1	3.2

<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>
Revenue (%)	5.2	-3.9	-4.4	-2.7	-1.6
EBITDA (%)	-17.6	-16.1	3.0	1.7	-3.4
EBIT (%)	-21.6	-17.8	0.7	2.3	-4.5
Normalised NPAT (%)	-17.3	-36.4	20.3	3.2	-5.3
Normalised EPS (%)	-17.3	-36.4	20.3	3.2	-5.3
Ordinary DPS (%)	0.0	-4.4	-6.2	-1.6	0.0

<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Return on assets (%)	7.2	8.0	6.9	7.2	6.9
Return on equity (%)	9.7	6.9	8.5	8.8	8.4
Return on funds employed (%)	7.2	5.6	6.1	6.3	6.1
EBITDA margin (%)	21.6	18.8	20.3	21.2	20.8
EBIT margin (%)	17.0	14.5	15.3	16.1	15.6
Capex to sales (%)	3.0	4.5	3.3	3.4	3.6
Capex to depreciation (%)	98	142	92	95	96
Imputation (%)	55	100	100	100	100
Pay-out ratio (%)	199	138	107	102	108

<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>222.2</b>	<b>186.5</b>	<b>192.0</b>	<b>195.3</b>	<b>188.7</b>
Working capital change	(47.1)	1.7	4.3	5.4	8.4
Interest & tax paid	(74.8)	(77.1)	(57.3)	(58.0)	(56.4)
Other	20.0	10.9	(0.6)	(0.6)	(0.6)
<b>Operating cash flow</b>	<b>120.3</b>	<b>121.9</b>	<b>138.4</b>	<b>142.0</b>	<b>140.0</b>
Capital expenditure	(31.1)	(44.7)	(30.9)	(31.7)	(32.3)
(Acquisitions)/divestments	8.1	20.2	0	0	0
Other	0	(6.8)	(6.8)	(6.8)	(6.8)
<b>Funding available/(required)</b>	<b>97.3</b>	<b>90.6</b>	<b>100.7</b>	<b>103.6</b>	<b>101.0</b>
Dividends paid	(190.4)	(156.7)	(97.0)	(93.9)	(93.9)
Equity raised/(returned)	(1)	(1)	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(94.5)</b>	<b>(67.4)</b>	<b>3.7</b>	<b>9.7</b>	<b>7.1</b>

<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
NZ electricity revenue	861	804	763	728	704
Gas revenue	29	30	33	34	36
Telecommunication revenue	88	98	95	107	114
Other revenue	52	58	56	52	53
<b>Total revenue</b>	<b>1,030</b>	<b>990</b>	<b>947</b>	<b>921</b>	<b>906</b>

Generation (GWh)	1,995	1,758	1,776	1,896	1,896
NZ GWAP (\$/MWh)	125	107	120	74	62

<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Working capital	(0.3)	(8.2)	15.1	16.1	14.6
Fixed assets	1,924.7	1,836.4	1,828.5	1,820.9	1,813.2
Intangibles	37.0	38.7	37.7	37.4	37.7
Right of use asset	0	35.5	35.5	35.5	35.5
Other assets	114.8	100.2	72.6	66.2	59.4
<b>Total funds employed</b>	<b>2,076.2</b>	<b>2,002.6</b>	<b>1,989.5</b>	<b>1,976.1</b>	<b>1,960.3</b>
Net debt/(cash)	557.4	616.7	613.0	603.4	596.3
Lease liability	0	36.1	36.1	36.1	36.1
Other liabilities	269.8	249.8	251.9	253.2	253.8
Shareholder's funds	1,224.4	1,076.2	1,062.0	1,054.4	1,042.3
Minority interests	24.6	23.8	26.4	29.1	31.8
<b>Total funding sources</b>	<b>2,076.2</b>	<b>2,002.6</b>	<b>1,989.5</b>	<b>1,976.1</b>	<b>1,960.3</b>

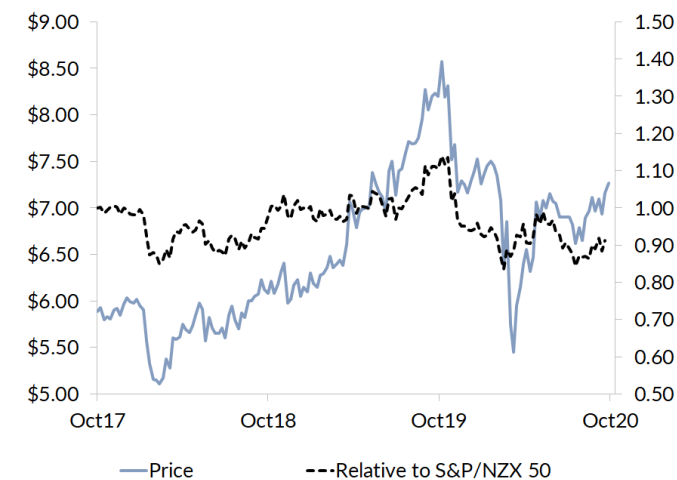
Mass market sales (GWh)	1,845	1,817	1,826	1,772	1,758
TOU sales (GWh)	880	826	693	771	775
Spot sales (GWh)	1,021	972	865	932	935
<b>Total Sales (GWh)</b>	<b>3,746</b>	<b>3,615</b>	<b>3,383</b>	<b>3,475</b>	<b>3,468</b>
LWAP (\$/MWh)	131	109	121	76	64
LWAP/GWAP	1.04	1.01	1.02	1.03	1.03
Electricity customers (000)	267	266	263	260	257
Usage/customer (MWh)	6.8	6.8	6.9	6.8	6.8
Revenue/MWh sold (\$)	230	222	226	209	203
Gas customers (000)	39	41	42	43	44
Volume/customer (GJ)	26.5	24.9	25.7	25.7	25.7
Telco customers (000)	96	104	110	115	119
Revenue/customer (\$)	963	983	987	997	1,007

## Summary forecast changes

Figure 1. Summary forecast changes

	FY21 Old	FY21 New	Chg	FY22 Old	FY22 New	Chg	FY23 Old	FY23 New	Chg
	NZ\$m	NZ\$m	%	NZ\$m	NZ\$m	%	NZ\$m	NZ\$m	%
Revenue	933	947	1.4%	917	921	0.4%	910	906	-0.4%
<b>EBITDAF</b>	<b>190</b>	<b>192</b>	<b>1.0%</b>	<b>191</b>	<b>195</b>	<b>2.4%</b>	<b>183</b>	<b>189</b>	<b>3.2%</b>
EBIT	143	145	1.4%	144	148	3.2%	136	142	4.3%
NPAT	84	85	1.7%	86	89	3.9%	80	85	5.4%
Normalised Profit	81	83	1.7%	83	86	4.0%	77	82	5.6%
DPS	30.0	30.5	1.7%	30.0	30.0	0.0%	30.0	30.0	0.0%
Generation volumes (GWh)	1,841	1,776	-3.6%	1,896	1,896	0.0%	1,896	1,896	0.0%
Electricity Wholesale Price (\$/MWh)	\$100.4	\$117.4	17.0%	\$67.0	\$74.2	10.8%	\$62.4	\$62.4	0.0%
Retail sales (GWh)	2,506	2,519	0.5%	2,534	2,543	0.3%	2,524	2,533	0.4%

Source: Forsyth Barr analysis

**Figure 2. Price performance**


Source: Forsyth Barr analysis

**Figure 3. Substantial shareholders**

Shareholder	Latest Holding
Infratil	51.0%
TECT Holdings	26.8%

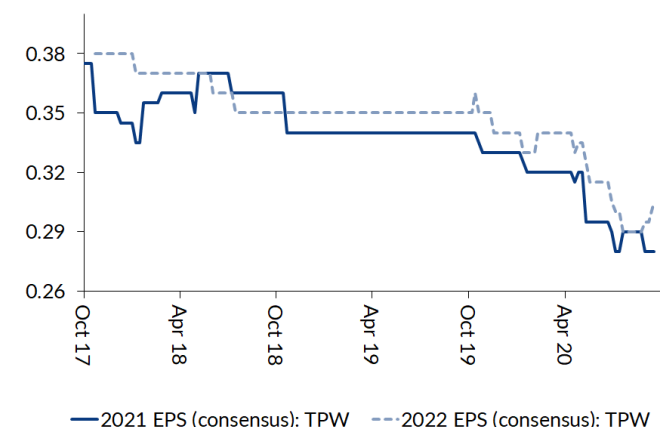
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 4. International valuation comparisons**

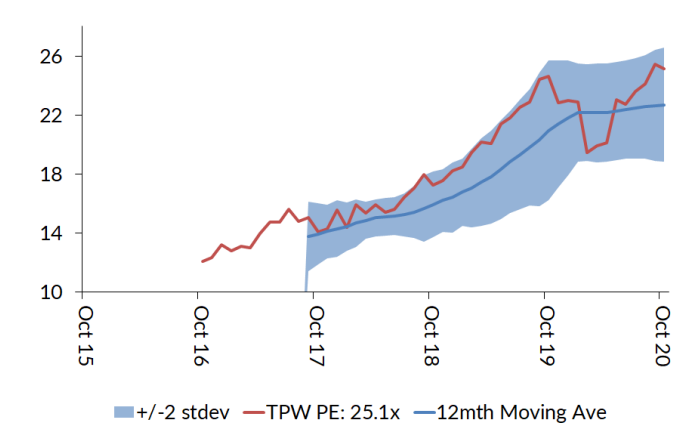
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect TPW's balance date - March)										
Trustpower	TPW NZ	NZ\$7.27	NZ\$2,275	25.6x	24.8x	15.1x	14.8x	20.0x	19.5x	4.1%
CONTACT ENERGY *	CEN NZ	NZ\$6.93	NZ\$4,977	20.1x	23.6x	13.1x	14.6x	28.0x	33.9x	4.6%
GENESIS ENERGY *	GNE NZ	NZ\$3.05	NZ\$3,178	17.8x	16.8x	11.4x	11.6x	25.2x	27.7x	4.6%
MERIDIAN ENERGY *	MEL NZ	NZ\$4.97	NZ\$12,736	28.3x	32.3x	18.5x	20.8x	30.8x	37.5x	3.4%
MERCURY *	MCY NZ	NZ\$5.15	NZ\$7,016	27.4x	28.0x	16.5x	16.5x	29.2x	30.4x	3.3%
AGL ENERGY	AGL AT	A\$13.50	A\$8,411	12.4x	15.8x	5.8x	6.6x	9.8x	12.2x	6.3%
ORIGIN ENERGY	ORG AT	A\$4.26	A\$7,503	36.7x	14.0x	22.0x	5.0x	4.9x	15.5x	5.3%
Compco Average:				23.8x	21.7x	14.5x	12.5x	21.3x	26.2x	4.6%
TPW Relative:				8%	14%	4%	18%	-6%	-26%	-10%

EV = Current Market Cap + Actual Net Debt

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