

# Trustpower

## Return of the Smelter

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### NEUTRAL

We are upgrading Trustpower's (TPW) forecasts materially following the announcement that NZAS will remain open to at least 31 December 2024. TPW's main downside risk from NZAS closing was a drop in retail prices in reaction to lower wholesale electricity prices - that will no longer occur. Our medium-term forecast increases are significant, FY22 EBITDAF up +11% and FY23 up +19%. That has flowed through to our dividend forecast which are up a similar level (up +6%, +13% and +13% in FY21, FY22 and FY23 respectively) and our target price, up +NZ\$0.60 (+8%) to NZ\$8.10.

NZX Code	TPW	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$8.78	NPAT* (NZ\$m)	74.2	81.2	95.2	100.7	PE	37.2	34.0	29.0	27.4
Target price	NZ\$8.10	EPS* (NZc)	23.6	25.8	30.3	32.1	EV/EBIT	23.4	24.0	21.1	20.0
Risk rating	Low	EPS growth* (%)	-36.4	9.4	17.3	5.8	EV/EBITDA	18.1	18.2	16.4	15.8
Issued shares	313.0m	DPS (NZc)	32.5	34.0	34.0	34.0	Price / NTA	2.6	2.7	2.7	2.7
Market cap	NZ\$2,748m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.7	3.9	3.9	3.9
Avg daily turnover	52.2k (NZ\$367k)	*Based on normalised profits					Gross div yld (%)	5.1	5.4	5.4	5.4

#### What's changed?

- **Earnings (EBITDAF):** FY21 -\$4m (-2%) to NZ\$189m, FY22 +\$21m (+11%) to NZ\$211m, FY23 +\$36m (+19%) to NZ\$220m
- **Dividend:** FY21 +2.0cps (+6%) to 34cps, FY22 +4.0cps (+13%) to 34cps, FY23 +4.0cps (+13%) to 34cps
- **Target price:** Increased +NZ\$0.60 (+8%) to NZ\$8.10

#### Material increase to medium-term forecasts

TPW's main exposure to NZAS closing was the indirect effects of lower wholesale electricity prices flowing into retail prices. That downside risk is no longer there and with wholesale electricity prices remaining high (the 2022 Otahuhu futures price is above NZ\$120/MWh), retail prices are more likely to increase than decrease. As a result, there are material increases in our earnings and dividend forecasts. Our FY22 and FY23 EBITDAF forecasts are up +NZ\$21m and +NZ\$36m to NZ\$211m and NZ\$220m respectively. We also forecast a flat 34cps dividend for the foreseeable future, this is +2.0cps higher than our old FY21 forecast and +4.0cps higher than our old FY22 forecast.

#### Modest decrease to FY21 EBITDAF due to low hydro generation volumes

Whilst the medium-term outlook has improved materially, we have trimmed our FY21 EBITDAF forecast -NZ\$4m (-2%) to NZ\$189m due to continued low hydro sequences.

## Trustpower Ltd (TPW)

Priced as at 15 Jan 2021 (NZ\$)

8.78

### 12-month target price (NZ\$)\*

8.10

Expected share price return

-7.7%

Net dividend yield

3.9%

Estimated 12-month return

-3.9%

### Spot valuations (NZ\$)

1. DCF

7.70

2. Market multiples

7.77

3. Dividend Yield

8.19

### Key WACC assumptions

Risk free rate

1.30%

Equity beta

0.84

WACC

5.2%

Terminal growth

1.5%

### DCF valuation summary (NZ\$m)

Total firm value

3,088

(Net debt)/cash

(662)

Less: Capitalised operating leases

Value of equity

2,410

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	1,030.1	989.9	941.2	969.8	960.2	EV/EBITDA (x)	14.7	18.1	18.2	16.4	15.8
<b>Normalised EBITDA</b>	<b>222.2</b>	<b>186.5</b>	<b>188.8</b>	<b>210.9</b>	<b>219.7</b>	EV/EBIT (x)	18.7	23.4	24.0	21.1	20.0
Depreciation and amortisation	(47.2)	(42.6)	(45.1)	(46.4)	(46.6)	PE (x)	23.7	37.2	34.0	29.0	27.4
<b>Normalised EBIT</b>	<b>175</b>	<b>144</b>	<b>144</b>	<b>165</b>	<b>173</b>	Price/NTA (x)	2.3	2.6	2.7	2.7	2.7
Net interest	(28)	(32)	(30)	(29)	(29)	Free cash flow yield (%)	3.2	2.8	3.4	3.4	3.8
Depreciation capex adjustment	19	(2)	3	0	(0)	Net dividend yield (%)	8.4	3.7	3.9	3.9	3.9
Tax	(45)	(32)	(33)	(38)	(40)	Gross dividend yield (%)	10.2	5.1	5.4	5.4	5.4
Minority interests	(2)	(3)	(2)	(3)	(3)						
<b>Normalised NPAT</b>	<b>117</b>	<b>74</b>	<b>81</b>	<b>95</b>	<b>101</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other/depn adj	(26)	21	(21)	(0)	0	Interest cover EBIT (x)	6.8	4.9	5.2	6.2	6.4
<b>Reported NPAT</b>	<b>91</b>	<b>95</b>	<b>60</b>	<b>95</b>	<b>101</b>	Interest cover EBITDA (x)	7.9	5.9	6.3	7.3	7.5
Normalised EPS (cps)	37.1	23.6	25.8	30.3	32.1	Net debt/ND+E (%)	58.6	64.8	69.4	70.9	71.6
DPS (cps)	74.0	32.5	34.0	34.0	34.0	Net debt/EBITDA (x)	2.5	3.3	3.5	3.3	3.2
Growth Rates	2019A	2020A	2021A	2022A	2023A	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.2	-3.9	-4.9	3.0	-1.0	Return on assets (%)	7.2	8.0	5.5	7.6	8.0
EBITDA (%)	-17.6	-16.1	1.3	11.7	4.2	Return on equity (%)	9.7	6.9	7.9	9.4	10.0
EBIT (%)	-21.6	-17.8	-0.1	14.5	5.2	Return on funds employed (%)	7.2	5.6	6.4	6.8	7.1
Normalised NPAT (%)	-17.3	-36.4	9.4	17.3	5.8	EBITDA margin (%)	21.6	18.8	20.1	21.8	22.9
Normalised EPS (%)	-17.3	-36.4	9.4	17.3	5.8	EBIT margin (%)	17.0	14.5	15.3	17.0	18.0
Ordinary DPS (%)	0.0	-4.4	4.6	0.0	0.0	Capex to sales (%)	3.0	4.5	3.7	4.0	4.1
						Capex to depreciation (%)	98	142	107	119	120
						Imputation (%)	55	100	100	100	100
						Pay-out ratio (%)	199	138	132	112	106
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Operating Performance	2019A	2020A	2021E	2022E	2023E
<b>EBITDA</b>	<b>222.2</b>	<b>186.5</b>	<b>188.8</b>	<b>210.9</b>	<b>219.7</b>	NZ electricity revenue	861	804	760	783	766
Working capital change	(47.1)	1.7	(15.2)	(13.5)	(9.1)	Gas revenue	29	30	31	32	34
Interest & tax paid	(74.8)	(77.1)	(68.9)	(65.0)	(68.0)	Telecommunication revenue	88	98	99	102	107
Other	20.0	10.9	23.2	1.3	1.3	Other revenue	52	58	51	52	53
<b>Operating cash flow</b>	<b>120.3</b>	<b>121.9</b>	<b>128.0</b>	<b>133.7</b>	<b>143.9</b>	<b>Total revenue</b>	<b>1,030</b>	<b>990</b>	<b>941</b>	<b>970</b>	<b>960</b>
Capital expenditure	(31.1)	(44.7)	(34.8)	(39.0)	(39.7)						
(Acquisitions)/divestments	8.1	20.2	0	0	0	Generation (GWh)	1,995	1,758	1,681	1,918	1,939
Other	0	(6.8)	(8.7)	(8.7)	(8.7)	NZ GWAP (\$/MWh)	125	107	130	131	104
<b>Funding available/(required)</b>	<b>97.3</b>	<b>90.6</b>	<b>84.5</b>	<b>86.0</b>	<b>95.5</b>						
Dividends paid	(190.4)	(156.7)	(103.4)	(106.4)	(106.4)	Mass market sales (GWh)	1,845	1,817	1,834	1,792	1,786
Equity raised/(returned)	(1)	(1)	0	0	0	TOU sales (GWh)	880	826	536	587	590
<b>(Increase)/decrease in net debt</b>	<b>(94.5)</b>	<b>(67.4)</b>	<b>(18.9)</b>	<b>(20.4)</b>	<b>(10.9)</b>	Spot sales (GWh)	1,021	972	866	933	937
						<b>Total Sales (GWh)</b>	<b>3,746</b>	<b>3,615</b>	<b>3,235</b>	<b>3,312</b>	<b>3,313</b>
						LWAP (\$/MWh)	131	109	132	136	108
						LWAP/GWAP	1.04	1.02	1.02	1.04	1.04
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Electricity customers (000)	267	266	262	260	259
Working capital	(0.3)	(8.2)	25.1	29.3	31.0	Usage/customer (MWh)	6.8	6.8	7.0	6.9	6.9
Fixed assets	1,924.7	1,836.4	1,835.6	1,835.7	1,835.9	Revenue/MWh sold (\$)	230	222	235	236	231
Intangibles	37.0	38.7	37.8	37.6	37.9	Gas customers (000)	39	41	43	43	44
Right of use asset	0	35.5	37.1	37.1	37.1	Volume/customer (GJ)	26.5	24.9	25.9	25.9	25.9
Other assets	114.8	100.2	111.2	120.6	128.0	Telco customers (000)	96	104	109	113	116
<b>Total funds employed</b>	<b>2,076.2</b>	<b>2,002.6</b>	<b>2,046.8</b>	<b>2,060.3</b>	<b>2,069.9</b>	Revenue/customer (\$)	963	983	978	988	998
Net debt/(cash)	557.4	616.7	667.0	687.4	698.3						
Lease liability	0	36.1	38.2	38.2	38.2						
Other liabilities	269.8	249.8	270.0	271.9	273.4						
Shareholder's funds	1,224.4	1,076.2	1,046.9	1,035.6	1,030.2						
Minority interests	24.6	23.8	24.7	27.2	29.8						
<b>Total funding sources</b>	<b>2,076.2</b>	<b>2,002.6</b>	<b>2,046.8</b>	<b>2,060.3</b>	<b>2,069.9</b>						

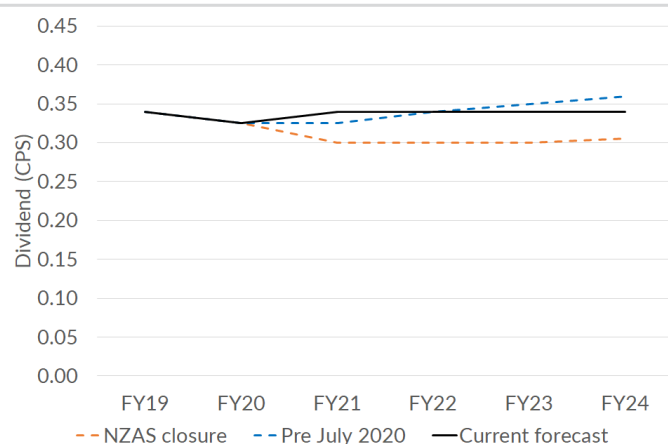
## Summary forecast changes

Figure 1. Summary forecast changes

	FY21 Old	FY21 New	Chg	FY22 Old	FY22 New	Chg	FY23 Old	FY23 New	Chg
	\$m	\$m	%	\$m	\$m	%	\$m	\$m	%
Revenue	927	941	1.5%	880	970	10.2%	859	960	11.8%
<b>EBITDAF</b>	<b>192</b>	<b>189</b>	<b>-1.9%</b>	<b>190</b>	<b>211</b>	<b>11.2%</b>	<b>184</b>	<b>220</b>	<b>19.5%</b>
EBIT	147	144	-2.5%	143	165	14.8%	137	173	26.1%
NPAT	65	62	-4.0%	82	98	18.7%	78	104	33.6%
Normalised Profit	82	79	-3.2%	80	95	19.2%	75	101	34.7%
<b>DPS</b>	<b>32.0</b>	<b>34.0</b>	<b>6.3%</b>	<b>30.0</b>	<b>34.0</b>	<b>13.3%</b>	<b>30.0</b>	<b>34.0</b>	<b>13.3%</b>
Generation volumes (GWh)	1,702	1,681	-1.2%	1,918	1,918	0.0%	1,939	1,939	0.0%
Generation sales price (\$/MWh)	\$120.8	\$129.8	7.4%	\$75.9	\$131.0	72.7%	\$61.5	\$104.0	69.1%
Retail sales (GWh)	2,369	2,369	0.0%	2,375	2,379	0.2%	2,363	2,376	0.6%

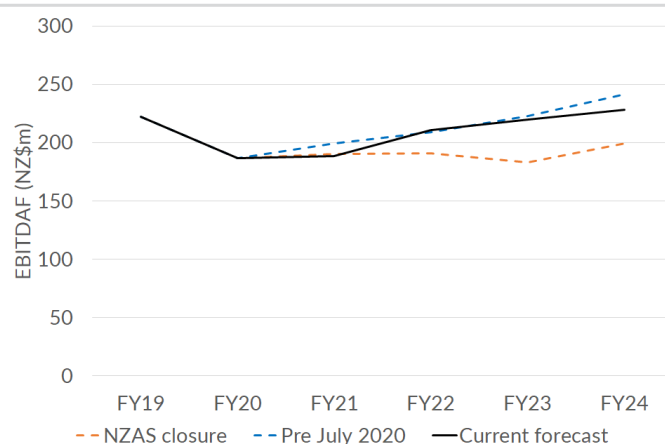
Source: Forsyth Barr analysis

Figure 2. Changes to forecast dividends

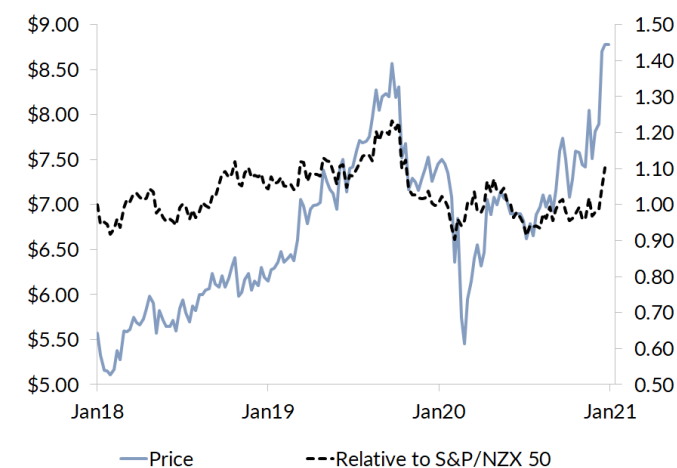


Source: Forsyth Barr analysis

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
Infratil	51.0%
TECT Holdings	26.8%

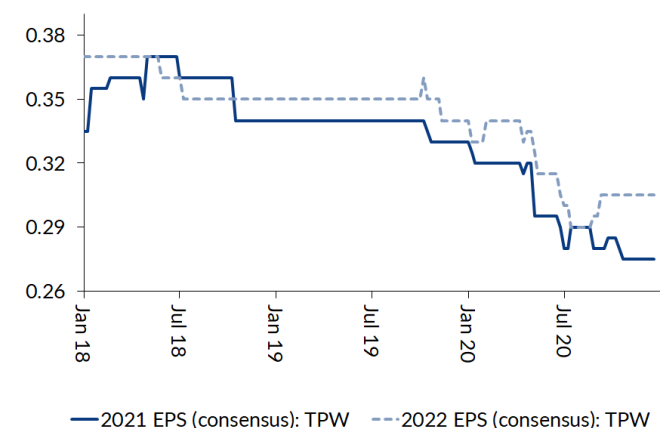
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 6. International valuation comparisons**

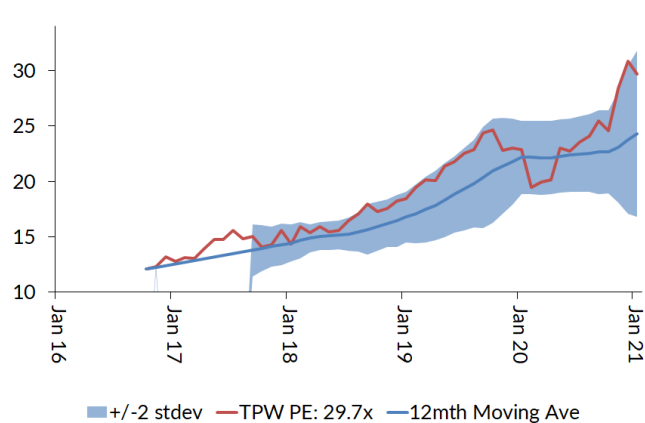
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect TPW's balance date - March)										
Trustpower	TPW NZ	NZ\$8.78	NZ\$2,748	34.0x	29.0x	17.8x	16.0x	23.4x	20.5x	3.9%
CONTACT ENERGY *	CEN NZ	NZ\$10.04	NZ\$7,214	29.6x	29.9x	18.1x	18.0x	39.5x	37.8x	3.6%
GENESIS ENERGY *	GNE NZ	NZ\$3.78	NZ\$3,945	22.0x	18.7x	13.3x	12.2x	29.2x	25.0x	4.7%
MERIDIAN ENERGY *	MEL NZ	NZ\$8.42	NZ\$21,577	>50x	>50x	31.1x	31.5x	53.4x	54.3x	2.0%
MERCURY *	MCY NZ	NZ\$7.08	NZ\$9,645	37.0x	33.5x	21.5x	19.7x	37.7x	33.8x	2.6%
AGL ENERGY	AGLAT	A\$12.23	A\$7,620	12.3x	18.0x	5.7x	6.8x	9.8x	13.8x	5.6%
ORIGIN ENERGY	ORG AT	A\$5.11	A\$9,000	44.1x	17.7x	24.9x	5.9x	6.9x	20.5x	4.5%
Compco Average:				29.0x	23.6x	19.1x	15.7x	29.4x	30.9x	3.8%
TPW Relative:				17%	23%	-7%	2%	-20%	-34%	1%

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


Source: Forsyth Barr analysis

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


Source: Forsyth Barr analysis

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