

# Vector

## No Change in Direction — 1H21 Result Review

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### NEUTRAL

Vector's (VCT) 1H21 EBITDA result of NZ\$274m was better than expected (+NZ\$17m better) due to a strong performance in its Networks division and was up +3.5% on 1H20. However, the result was driven by the retention of loss rental rebates totalling NZ\$21.1m. The good result saw VCT upgrade FY21 EBITDA guidance +NZ\$20m, to between NZ\$500–NZ\$520m, up from NZ\$480m–NZ\$500m. We have lifted our FY21 EBITDA forecast +NZ\$17m to NZ\$513m. Given the recent rise in interest rates we foresee near term headwinds for high yield stocks and retain our NEUTRAL rating.

NZX Code	VCT	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$4.07	NPAT* (NZ\$m)	118.4	165.7	150.9	157.1	PE	34.2	24.5	26.9	25.8
Target price	NZ\$4.20	EPS* (NZc)	11.9	16.6	15.1	15.8	EV/EBIT	21.8	20.9	21.3	20.4
Risk rating	Low	EPS growth* (%)	1.7	39.9	-8.9	4.1	EV/EBITDA	11.9	11.6	11.6	11.1
Issued shares	995.8m	DPS (NZc)	16.5	16.5	16.5	16.8	Price / NTA	4.2	4.2	4.3	4.3
Market cap	NZ\$4,053m	Imputation (%)	30	30	30	30	Cash div yld (%)	4.1	4.1	4.1	4.1
Avg daily turnover	174.4k (NZ\$664k)	*Based on normalised profits					Gross div yld (%)	4.5	4.5	4.5	4.6

#### What's changed?

- **Earnings:** Modest upgrades: FY21 EBITDA +3% to NZ\$513m, FY22 and FY23 +1% to NZ\$525m and NZ\$552m respectively
- **Target price:** Lowered -6% to NZ\$4.20 from NZ\$4.45, due to an increased WACC caused by rising bond rates

#### Main story in result is the strong Network performance despite the regulatory price cut

VCT's 1H21 EBITDA of NZ\$274m was up +NZ\$10m on 1H20 with growth coming from the continued smart meter roll out (+NZ\$7m), a strong Network performance (+NZ\$7m), offset by the expected lower Gas Trading contribution (-NZ\$6m). The upside vs. our forecasts came from the retention of loss rental rebates (LRR) of NZ\$21m. LRRs are a function of the wholesale electricity market. In the past VCT returned LRRs to customers, but in 1H21 VCT retained LRRs in order to smooth customer price movements. The regulatory electricity price increase on 1 April 2021 will now be lower than it otherwise would have been. Whilst it appears VCT is retaining LRRs at the expense of customers, customers will still benefit, just in a later period than previously.

#### Target price reduction largely a result of WACC increase

We now forecast FY21 EBITDA to be NZ\$513m, up +NZ\$17m on our previous forecasts due to the inclusion of the retained LRRs. We have made only modest changes to our longer dated earnings expectations. However, we have lowered our target price -25cps (-6%) to NZ\$4.20, primarily as a result of cost of capital assumption changes. In the past few months 10 year bond rates have increased sharply, back to near pre COVID-19 levels. This has resulted in VCT's cost of capital rising +0.5% to 5.3%. Whilst our DCF is only down -3% (higher interest rates boost regulatory earnings), we are now targeting a higher dividend yield.

#### CCC report and the impacts on VCT

The Climate Change Commission's (CCC) draft report has several implications for VCT. The push to adopt EVs has been well canvassed, however, the proposal to ban new LPG and gas connections from 2025 is new. Whilst it is too early to assess potential value implications, banning LPG/gas connections will negatively impact VCT's gas network business and LPG business. This will be offset by increased electricity network investment and returns to enable VCT to meet peak electricity demand requirements as households transition to electricity for cooking, space heating and hot water.

## Vector Limited (VCT)

Priced as at 23 Feb 2021 (NZ\$) **4.07**

<b>12-month target price (NZ\$)*</b>	<b>4.20</b>
Expected share price return	3.2%
Net dividend yield	4.1%
Estimated 12-month return	7.2%

<b>Key WACC assumptions</b>	
Risk free rate	2.30%
Equity beta	0.84
WACC	5.3%
Terminal growth	1.5%

<b>Spot valuations (NZ\$)</b>	
1. DCF	3.99
2. Dividend growth	4.19
3. n/a	n/a

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	6,936
(Net debt)/cash	(2,964)
Less: Capitalised operating leases	(38)
Value of equity	3,972

<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	1,318.6	1,294.0	1,274.7	1,315.0	1,355.6
<b>Normalised EBITDA</b>	<b>565.1</b>	<b>576.4</b>	<b>610.0</b>	<b>621.1</b>	<b>647.6</b>
Depreciation and amortisation	(246.8)	(262.8)	(271.2)	(283.4)	(295.1)
<b>Normalised EBIT</b>	<b>318.3</b>	<b>313.6</b>	<b>338.8</b>	<b>337.6</b>	<b>352.5</b>
Net interest	(133.3)	(126.5)	(116.3)	(122.8)	(128.8)
Associate income	0.6	0.3	1.8	0.3	0.3
Tax	(52.5)	(55.2)	(56.1)	(62.4)	(65.0)
Minority interests	(1.1)	(1.9)	(1.9)	(1.9)	(1.9)
<b>Normalised NPAT</b>	<b>116.5</b>	<b>118.4</b>	<b>165.7</b>	<b>150.9</b>	<b>157.1</b>
Abnormals/other	(33.6)	(23.0)	(1.6)	0	0
<b>Reported NPAT</b>	<b>82.9</b>	<b>95.4</b>	<b>164.1</b>	<b>150.9</b>	<b>157.1</b>
Normalised EPS (cps)	11.7	11.9	16.6	15.1	15.8
DPS (cps)	16.5	16.5	16.5	16.5	16.8

<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>
Revenue (%)	0.6	-1.9	-1.5	3.2	3.1
EBITDA (%)	4.3	2.0	5.8	1.8	4.3
EBIT (%)	0.8	-1.5	8.0	-0.3	4.4
Normalised NPAT (%)	-11.4	1.7	39.9	-8.9	4.1
Normalised EPS (%)	-11.4	1.7	39.9	-8.9	4.1
Ordinary DPS (%)	1.5	0.0	0.0	0.0	1.5

<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>565.1</b>	<b>576.4</b>	<b>610.0</b>	<b>621.1</b>	<b>647.6</b>
Working capital change	21.6	6.9	(37.3)	7.2	(1.5)
Interest & tax paid	(203.1)	(198.4)	(135.6)	(142.0)	(148.4)
Other	16.9	12.4	0	0	0
<b>Operating cash flow</b>	<b>400.5</b>	<b>397.3</b>	<b>437.1</b>	<b>486.3</b>	<b>497.7</b>
Capital expenditure	(418.4)	(476.4)	(494.6)	(505.3)	(482.7)
(Acquisitions)/divestments	(7.4)	0.2	0	0	0
Other	(1.6)	0	0	0	0
<b>Funding available/(required)</b>	<b>(26.9)</b>	<b>(78.9)</b>	<b>(57.5)</b>	<b>(19.0)</b>	<b>14.9</b>
Dividends paid	(164.1)	(167.0)	(164.4)	(164.4)	(166.9)
Equity raised/(returned)	0	0	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(191.0)</b>	<b>(245.9)</b>	<b>(221.9)</b>	<b>(183.4)</b>	<b>(151.9)</b>

<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Working capital	54.4	139.2	149.4	109.3	75.8
Fixed assets	4,184.6	4,367.7	4,591.1	4,813.0	5,000.6
Intangibles	1,354.9	1,283.4	1,283.4	1,283.4	1,283.4
Right of use asset	38.1	35.8	35.8	35.8	35.8
Other assets	135.5	244.5	246.3	246.6	246.9
<b>Total funds employed</b>	<b>5,767.5</b>	<b>6,070.6</b>	<b>6,306.0</b>	<b>6,488.0</b>	<b>6,642.5</b>
Net debt/(cash)	2,733.4	3,107.3	3,329.2	3,512.5	3,664.5
Lease liability	39.9	37.8	37.8	37.8	37.8
Other liabilities	644.8	665.8	675.5	685.7	696.1
Shareholder's funds	2,332.4	2,242.8	2,242.6	2,229.1	2,219.4
Minority interests	17.0	16.9	18.8	20.7	22.6
<b>Total funding sources</b>	<b>5,767.5</b>	<b>6,070.6</b>	<b>6,303.8</b>	<b>6,485.8</b>	<b>6,640.3</b>

<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
EV/EBITDA (x)	11.6	11.9	11.6	11.6	11.1
EV/EBIT (x)	20.6	21.8	20.9	21.3	20.4
PE (x)	34.8	34.2	24.5	26.9	25.8
Price/NTA (x)	4.1	4.2	4.2	4.3	4.3
Free cash flow yield (%)	-0.4	-2.0	-1.4	-0.5	0.4
Net dividend yield (%)	4.1	4.1	4.1	4.1	4.1
Gross dividend yield (%)	5.6	4.5	4.5	4.5	4.6

<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Interest cover EBIT (x)	2.4	2.5	2.9	2.8	2.7
Interest cover EBITDA (x)	4.2	4.6	5.2	5.1	5.0
Net debt/ND+E (%)	53.0	56.2	58.1	59.6	60.8
Net debt/EBITDA (x)	4.6	5.0	5.1	5.3	5.3

<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Return on assets (%)	5.3	4.9	5.1	5.0	5.1
Return on equity (%)	5.0	5.3	7.4	6.8	7.1
Return on funds employed (%)	4.6	4.3	4.7	4.3	4.4
EBITDA margin (%)	42.9	44.5	47.9	47.2	47.8
EBIT margin (%)	24.1	24.2	26.6	25.7	26.0
Capex to sales (%)	31.7	36.8	38.8	38.4	35.6
Capex to depreciation (%)	170	181	182	178	164
Imputation (%)	100	30	30	30	30
Pay-out ratio (%)	141	139	99	109	106

<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Electricity throughput (GWh)	8,410	8,315	8,378	8,508	8,667
Electricity connections (000)	571	580	591	603	614
Volume/customer (MWh)	14.8	14.4	14.3	14.3	14.3
Price (\$/MWh)	50.3	49.4	47.7	48.4	49.1
Gas distribution (PJ)	14.4	14.3	14.3	14.6	14.8
Gas connections (000)	112	114	116	118	120
Volume/customer (GJ)	130	127	124	125	125
Natural gas sales (PJ)	16.1	12.4	9.5	9.4	9.2
Liquid sales (000 tonnes)	737.3	745.3	767.2	783.9	800.6
Liquigas tolling (000 tonnes)	152	116	113	110	108
Smart meters (000)	1,558	1,714	1,885	2,036	2,178
Total meters (000)	1,875	2,027	2,208	2,412	2,582
Smart meter %	83.1	84.6	85.4	84.4	84.4

<b>Divisional EBITDA (NZ\$m)</b>					
Electricity	403	379	401	391	395
Gas Transport	43	44	46	47	51
Gas Trading	31	34	25	25	25
Metering	139	155	171	190	207
Corporate/Other	(50.9)	(35.60)	(33.0)	(32.0)	(30.9)
<b>Total EBITDA</b>	<b>565</b>	<b>576</b>	<b>610</b>	<b>621</b>	<b>648</b>
Customer contributions	79	86	97	96	95
<b>Adjusted EBITDA</b>	<b>486</b>	<b>490</b>	<b>513</b>	<b>525</b>	<b>552</b>

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

## Summary forecast changes

Figure 1. Summary forecast changes

	FY21 Old	FY21 New	Chg %	FY22 Old	FY22 New	Chg %	FY23 Old	FY23 New	Chg %
Revenue	1,258	1,275	1%	1,298	1,315	1%	1,339	1,356	1%
EBITDA excl Capital Contributions	496	513	3%	521	525	1%	548	552	1%
EBITDA	589	610	3%	614	621	1%	640	648	1%
EBIT	323	339	5%	333	338	1%	347	352	2%
NPAT	151	166	10%	154	153	-1%	160	159	-1%
REPORTED PROFIT	149	164	10%	152	151	-1%	158	157	-1%
EPS	14.9	16.5	10%	15.2	15.2	-1%	15.9	15.8	-1%
Dividend (cps)	16.50	16.50	0%	16.50	16.50	0%	16.75	16.75	0%

Source: Forsyth Barr analysis

Key changes to our forecast include:

- Network contribution increase (+NZ\$17m in FY21) due to LRR retention
- Increased Net Interest forecast as a result of higher than forecast 1H21 interest costs
- Capital Contributions increase of +NZ\$3m in FY21/FY22/FY23 due to increase in assumed connection growth

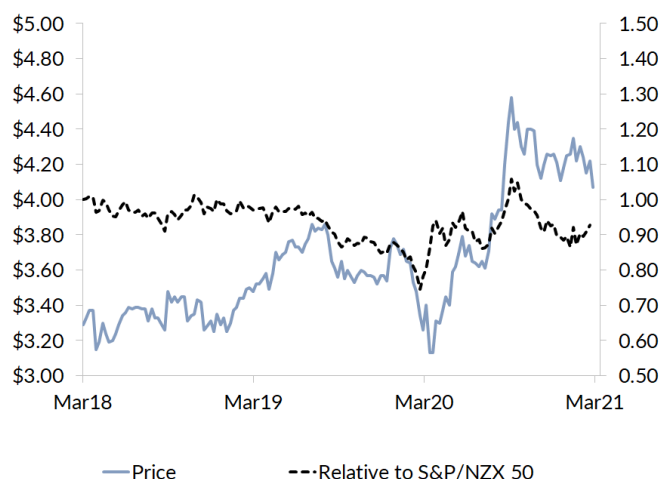
We have made no changes to our dividend (or imputation) forecasts.

## Result analysis

Figure 2. 1H21 result analysis (NZ\$m)

6 months ending 31 Dec (\$m)	1H20	1H21	% Chg	FB	Diff \$m	Commentary
<b>Revenue</b>						
Electricity & Gas	407	384	-6%	392	(8)	Regulated revenue impacted by DPP3 price reset which saw a price reduction of -6.9%
Gas Trading	151	114	-25%	106	8	Gas trading impacted by sale of Kapuni assets and lower natural gas sales
Metering	102	110	7%	108	2	Strong roll out in both NZ and Aus, with 2H21 expected to be above that of 1H21
Corporate/other	41	41	-1%	40	1	
Intersegment	(2)	(2)		(2)	0	
<b>Total Revenue</b>	<b>700</b>	<b>648</b>	<b>-7%</b>	<b>645</b>	<b>3</b>	
Total Costs	(390)	(323)	-17%	(334)	11	
<b>EBITDA</b>						
Electricity & Gas	189	196	4%	178	18	EBITDAF contribution improved due to retention of loss rental rebates
Gas Trading	21	15	-30%	14	1	Sale of Kapuni lowered Gas Trading EBITDA -NZ\$6m vs. pc
Metering	76	83	9%	82	2	Most of the growth has come from Australia – +NZ\$6m in Australia vs. NZ\$1.5m in NZ
Corporate/other	(22)	(20)	-10%	(17)	(3)	
<b>Adjusted EBITDA</b>	<b>264</b>	<b>274</b>	<b>4%</b>	<b>257</b>	<b>17</b>	
Capital contributions	45	51	13%	54	(3)	Strong connection growth
<b>Group EBITDA</b>	<b>309</b>	<b>325</b>	<b>5%</b>	<b>311</b>	<b>14</b>	
Depreciation & Amortisation	131	133	1%	133	-	
<b>EBIT</b>	<b>178</b>	<b>192</b>	<b>8%</b>	<b>179</b>	<b>14</b>	
FV of chg in fin. Instruments	(1)	(2)		-	(2)	
Equity Earnings	0	2		0	2	
Net Interest	(64)	(59)	-8%	(56)	(3)	Increased debt levels offset by lower interest rates in the period
<b>Pretax</b>	<b>114</b>	<b>133</b>	<b>17%</b>	<b>123</b>	<b>10</b>	
Tax Expense/(Benefit)	33	31	-8%	36	(5)	Tax lower than otherwise would have been due to NZ\$7.5m deferred tax credit
<b>NPAT</b>	<b>80</b>	<b>102</b>	<b>27%</b>	<b>87</b>	<b>15</b>	
Minority Interests	(1)	(1)	25%	(1)	(0)	
<b>REPORTED PROFIT</b>	<b>80</b>	<b>101</b>	<b>27%</b>	<b>87</b>	<b>15</b>	Growth in earnings & capital contributions
Abnormal items	-	-		-	-	
<b>Normalised NPAT</b>	<b>80</b>	<b>101</b>	<b>27%</b>	<b>87</b>	<b>15</b>	
Normalised EPS	8.0	10.2	27%	8.7	1.4	
Dividend per share	8.25	8.25	0%	8.25	0.00	In line with expectations, 30% imputed

Source: VCT, Forsyth Barr analysis

**Figure 3. Price performance**


Source: Forsyth Barr analysis

**Figure 4. Substantial shareholders**

Shareholder	Latest Holding
Entrust	75.1%

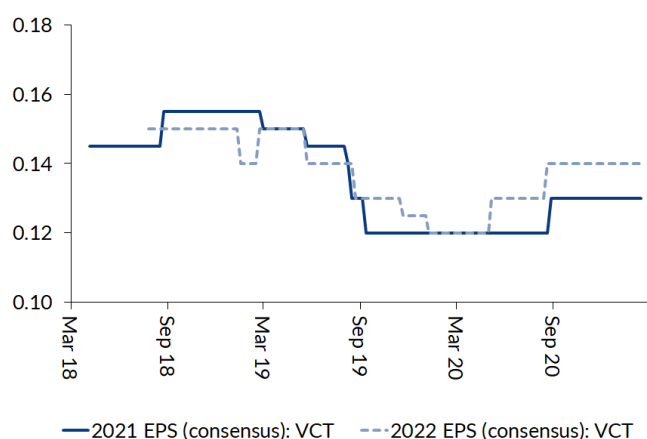
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 5. International valuation comparisons**

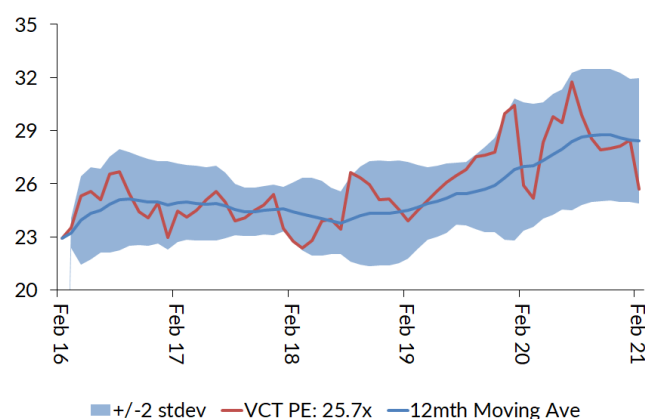
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect VCT's balance date - June)										
Vector	VCT NZ	NZ\$4.07	NZ\$4,053	24.5x	26.9x	11.4x	11.2x	20.5x	20.5x	4.1%
APA GROUP	APA AT	A\$9.17	A\$10,820	35.1x	30.4x	12.5x	11.9x	20.9x	19.5x	5.7%
AUSNET SERVICES	AST AT	A\$1.67	A\$6,329	19.0x	20.9x	12.7x	12.8x	20.8x	21.4x	5.8%
CHORUS*	CNU NZ	NZ\$7.77	NZ\$3,473	>50x	>50x	9.5x	9.4x	27.3x	27.8x	3.9%
SPARK INFRASTRUCTURE GROUP	SKI AT	A\$2.06	A\$3,580	>50x	>50x	6.3x	7.2x	15.1x	16.9x	5.9%
Compco Average:				27.1x	25.6x	10.3x	10.3x	21.0x	21.4x	5.3%
VCT Relative:				-10%	5%	11%	8%	-3%	-4%	-24%

EV = Current Market Cap + Actual Net Debt

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

**Figure 6. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 7. One year forward PE (x)**


Source: Forsyth Barr analysis

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