

Power Points

Priced to OUTPERFORM – May 2020

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

We are upgrading Meridian Energy (MEL) and Mercury (MCY) to OUTPERFORM in a sector-wide call that we expect the electricity stocks to do well in the coming months. Relative to other quality yield stocks and interest rates, the electricity sector is trading at a record discount. We do not expect this discount to last as the market recognises and pays for the electricity sector's defensive characteristics.

Figure 1. Summary company valuation metric

Company	Price	Target	Target	Rating	FY20			EBITDAF NZ\$m	Movements			
		Price	Return		EV/EBITDA	PE	Gr Yld		EBITDAF	Chg	Target Price	Rating
CEN	\$6.22	\$8.15	37.3%	OUTPERFORM	12.4	19.8	7.7%	431	-\$10m	-2.3%	+\$0.15	-
GNE	\$2.86	\$3.30	21.5%	OUTPERFORM	14.0	26.0	8.1%	359	-\$7m	-2.0%	+\$0.15	-
MCY	\$4.50	\$4.95	13.7%	OUTPERFORM	14.7	26.7	4.9%	493	-\$9m	-1.7%	+\$0.35	▲
MEL	\$4.48	\$4.80	12.0%	OUTPERFORM	15.0	22.7	6.0%	870	+\$6m	0.7%	+\$0.40	▲
TLT	\$3.16	\$3.50	10.8%	OUTPERFORM	14.4	18.1	0.0%	124	-	-	-	-
TPW	\$6.61	\$7.75	22.4%	OUTPERFORM	14.5	24.6	7.1%	187	-\$0m	-0.2%	+\$0.05	-

Source: Company reports, Forsyth Barr analysis

Electricity sector best value relative to other yield stocks and 10-year bond rates since 2014

Whilst the electricity sector had a strong performance in April, it is still offering excellent value for yield focussed investors. The median sector gross dividend yield is ~+40% higher than property and other bond proxy stocks and ~+6% higher than the current 10-year swap rate. Both are records. Looking ahead, we expect the electricity sector to perform well regardless of what happens in the wider economy. In a down-market, the sector's defensive qualities should come to the fore. In an up-market, similar to what has happened over much of the past few years, we expect there to be a focus on yield, again supportive of electricity outperforming the market. In addition, the number of truly defensive stocks in the market has diminished, increasing the attractiveness of the electricity sector – particularly once certainty around NZAS's future is attained.

Wholesale market dominated by countrywide lockdown

Whilst impacted by the COVID-19 lockdown, the electricity sector was not impacted as much as some sectors. Electricity demand in April 2020 was -12.5% down on the pcp, but is showing strong signs of a rebound with demand over the past week only down ~-5%. Wholesale electricity prices averaged \$48/MWh at Otahuhu (OTA), -37% lower than March 2020, but in our view that is reasonably firm considering the demand decline. Thermal generation volumes fell as expected, meaning renewable generation increased to 87% of total, with geothermal generation hitting a record high 23% market share. Other effects of the lockdown were very few EV sales and a material drop in retail gas churn, which we expect has been replicated in the electricity market.

Forecast changes relatively modest, underlining the sector's defensive characteristics

We have reviewed all of our electricity forecasts, taking into account the impact of COVID-19. Lower demand, lower wholesale electricity prices and higher bad debt provisions have all impacted on earnings. However, the sector wide impact on FY21 EBITDAF is only -1.4%. We have not amended our dividend forecasts and at this stage expect the electricity companies to maintain current dividend expectations. That said, there is a small risk CEN and TPW decide to take a more conservative approach and trim their dividend given FY20 earnings are well below average.

Expect increasing focus on defensive yield, benefiting electricity

We are taking a more positive investment stance on the electricity companies and expect the sector to perform well in both a significant economic downturn, but also in an economic rebound.

COVID-19 is having a significant impact on businesses, including some businesses that were perceived to be low risk, such as property and airports. In contrast, we believe that the earnings downside risk (and therefore the dividend downside risk) is largely immaterial for the electricity companies. These stocks should perform well relative to other investment options if the upcoming economic downturn is more pronounced than the market is currently expecting.

On the flip side, under improving economic conditions we also expect the electricity sector to perform well. Investors seeking income are likely to be wary of those sectors that have underperformed, building in a greater risk premium than observed over the past decade. In contrast, we expect the electricity sector's risk premium to fall.

Looking where electricity stocks are positioned at present, we see significant share price upside. Interest rates continue to fall and relative to other high quality yield stocks the electricity sector is offering the best value since post-the 2014 election. We have lowered our target dividend yields across the sector (and lifted target multiples), resulting in higher target prices and ratings upgrades for MCY and MEL to OUTPERFORM. We now, for the first time, have all electricity stocks on an OUTPERFORM rating.

Figure 2. Summary target price and rating changes

	Target gross dividend yield		Target PE ratio		Target price		Rating	
	Old	New	Old	New	Old	New	Old	New
Contact Energy (CEN)	6.25%	5.75%	22.0	24.0	\$8.00	\$8.15	OUTPERFORM	OUTPERFORM
Genesis Energy (GNE)	6.50%	6.25%	22.5	24.5	\$3.15	\$3.30	OUTPERFORM	OUTPERFORM
Mercury (MCY)	5.00%	4.25%	24.0	27.5	\$4.60	\$4.95	NEUTRAL	OUTPERFORM
Meridian Energy (MEL)	5.75%	5.00%	26.0	28.5	\$4.40	\$4.80	NEUTRAL	OUTPERFORM
Trustpower (TPW)	5.90%	5.75%	23.5	24.0	\$7.70	\$7.75	OUTPERFORM	OUTPERFORM

Source: Forsyth Barr analysis

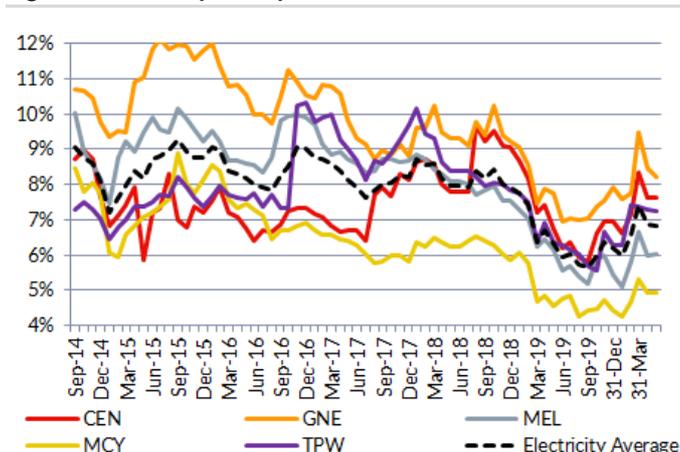
In arriving at our target dividend yields and PE ratios we have considered expected earnings growth, dividend growth, free cash flow payout, gearing, underlying asset quality, and liquidity.

Dividend yields attractive relative to other options and at a high vs. 10-year swap rates

The average gross electricity sector yield remains high, currently at 6.9%, albeit below the 15 month highs of 7.8% experienced in late March. This pull-back in yield is due to the bounce in share prices across the sector in April, with the average increase in stock price across the big five listed generators being +8.7% from 1 April to 5 May.

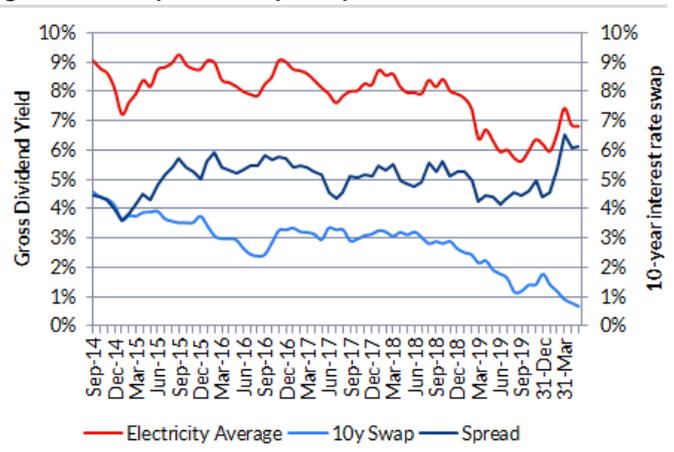
Whilst there has been intra-month volatility, COVID-19 has seen the downward move in interest rates resume after a brief hiatus in late 2019. The current 10-year swap rate is 0.7%, down from 0.9% a month ago. Despite the share price bounce, the spread between the 10-year swap rate and the sector average gross dividend yield remains above 6% – the highest since the 2014 election and is currently sitting at 6.14% as at 5 May. With the typical range for this spread being between 4.5% and 5.5% there is clear upside to electricity share prices should the spread contract to historic levels.

Figure 3. Electricity stock yields



Source: Bloomberg, Forsyth Barr analysis

Figure 4. Sector yield vs 10-yr swap rate

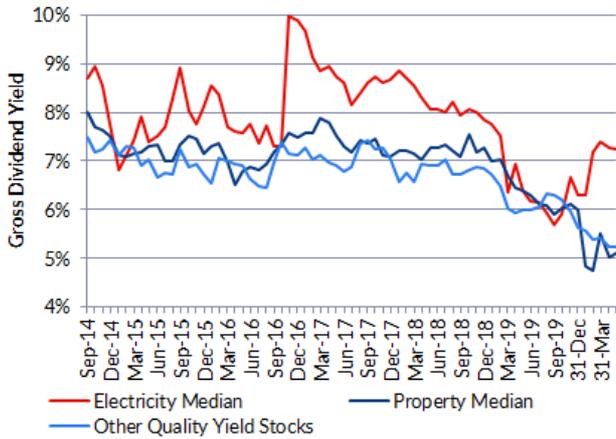


Source: Bloomberg, Forsyth Barr analysis

Compared to both property stocks and other bond proxies such as Chorus (CNU), Spark (SPK), and Vector (VCT), the electricity yields have increased in attractiveness over the past two months. On a relative basis, electricity yields have never (post the 2014 election) been higher at ~1.4x (having been below 1.0x at the end of 2019).

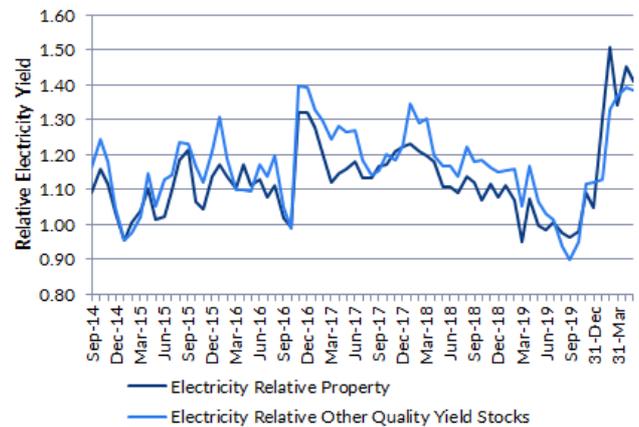
COVID-19 has seen property stocks cut dividends in line with share price falls; hence, the sector dividend yields have not changed materially, although arguably their risk profile has. The other bond proxies have not cut dividends but their share prices have held up well; hence, their gross dividend yields have also remained relatively constant. In contrast, whilst electricity stocks are also expected to maintain their dividends, share prices are off their peaks, hence, the increase in dividend yields.

Figure 5. Electricity yield vs property and other bond proxy



Source: Bloomberg, Forsyth Barr analysis

Figure 6. Relative yields

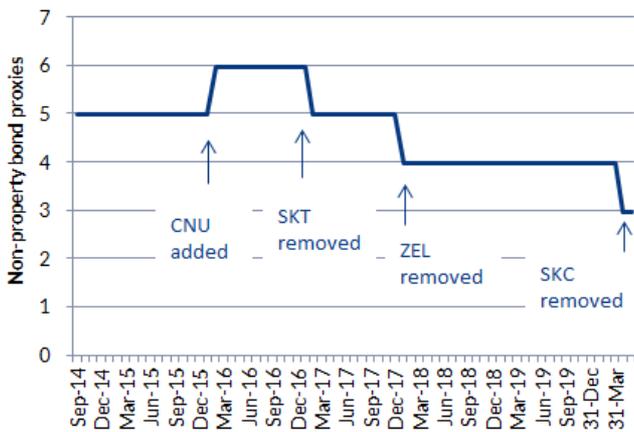


Source: Bloomberg, Forsyth Barr analysis

In addition, the number of truly defensive yield stocks continues to decline with SkyCity (SKC) being removed from our bond proxy list, joining Sky TV (SKT) and Z Energy (ZEL). Since 2014, only SPK and VCT have been constant on this list, highlighting that once the dust settles from COVID-19, investors are likely to realise that the pool of truly defensive stocks has shrunk.

The maths of share prices and gross dividend yield is compelling for the electricity stocks. If the average electricity sector yield were to fall from the current ~7.0% to ~5.5%, the share price appreciation would be +27%. Whilst we believe current electricity dividends are sustainable, a refocus on yield provides significant downside protection.

Figure 7. Number of bond proxy stocks



Source: Forsyth Barr analysis

Figure 8. Gross dividend yield/share price maths

		Gross dividend yield (start position is 7%)				
		5.0%	5.5%	6.0%	6.5%	7.0%
Dividend change	-25%	5%	-5%	-13%	-19%	-25%
	-20%	12%	2%	-7%	-14%	-20%
	-15%	19%	8%	-1%	-8%	-15%
	-10%	26%	15%	5%	-3%	-10%
	-5%	33%	21%	11%	2%	-5%
	0%	40%	27%	17%	8%	0%
	5%	47%	34%	23%	13%	5%
10%	54%	40%	28%	18%	10%	

Source: Forsyth Barr analysis

Dividend sustainability

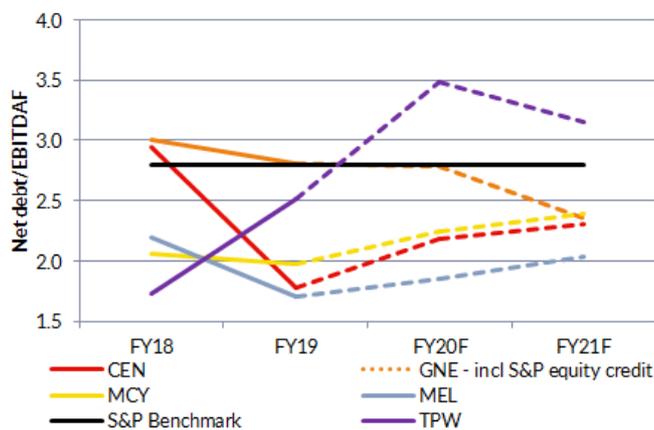
A question we are frequently asked is how sustainable are the electricity sector dividends? In our view, very sustainable, certainly relative to many other dividend yield stocks.

Reasons we are comfortable that electricity sector dividends are sustainable include:

- Earnings at risk is relatively minor
- Balance sheets are strong
- Free cash flow payout ratios generally provide a little headroom

That said, all businesses are dealing with uncertain times and it is possible some electricity companies may take a slightly more conservative approach. The electricity companies that we believe are most at risk to trimming their dividend are CEN and TPW as they have the highest payout ratios, and in TPW's case it has a relatively high gearing ratio (on a net debt to EBITDAF basis). However, even if CEN and TPW were to trim their dividend, it would be less than -10%. Whilst GNE has high gearing relative to some, it has the best earnings growth over the next two years as its expensive take-or-pay gas contracts roll off.

Figure 9. Net debt to EBITDAF



Source: Forsyth Barr analysis

Reforecasting the future

Forecast changes

Our analysis indicates the direct effects of the COVID-19 fall in demand are relatively minor. Most electricity is sold on fixed price terms, hence, the wholesale electricity price impacts are relatively minor and offset by lower cost of generation and increased high margin residential sales.

Our views are supported to date by both MCY and GNE downgrading FY20 EBITDAF, not due to COVID-19, but mainly due to lower North Island hydro generation volumes. The biggest impact on EBITDAF earnings from COVID-19 is only -2%.

Our forecast changes include:

- A revised electricity demand outlook
- A lower wholesale electricity price outlook
- Lift in bad debts likely from FY21
- 3Q20 operating statistics (4Q20 for TPW) vs. expectations

Figure 10. Summary of forecast changes

	FY20			FY21			FY22		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
EBITDAF (\$m)									
CEN	441	431	-2%	473	463	-2%	490	474	-3%
GNE	366	359	-2%	405	404	0%	437	433	-1%
MCY	501	493	-2%	526	514	-2%	554	542	-2%
MEL	864	870	1%	807	799	-1%	808	813	1%
TPW	187	187	0%	207	203	-2%	217	213	-2%
Sector	2,360	2,340	-1%	2,418	2,383	-1%	2,507	2,474	-1%
NPAT (\$m)									
CEN	232	224	-3%	249	244	-2%	253	249	-1%
GNE	164	158	-3%	199	198	0%	240	236	-2%
MCY	236	230	-3%	272	264	-3%	287	278	-3%
MEL	501	505	1%	451	444	-1%	451	454	1%
TPW	84	84	0%	101	97	-4%	107	103	-4%
Sector	1,216	1,202	-1%	1,272	1,247	-2%	1,337	1,321	-1%
Dividend (cps)									
CEN	39.0	39.0	0%	39.0	39.0	0%	39.0	39.0	0%
GNE	17.2	17.2	0%	17.5	17.5	0%	17.8	17.8	0%
MCY	15.8	15.8	0%	16.2	16.2	0%	18.6	18.1	-3%
MEL	21.5	21.6	1%	21.5	21.6	1%	21.2	21.3	1%
TPW	34.0	34.0	0%	34.0	34.0	0%	35.0	34.0	-3%

Source: Forsyth Barr analysis

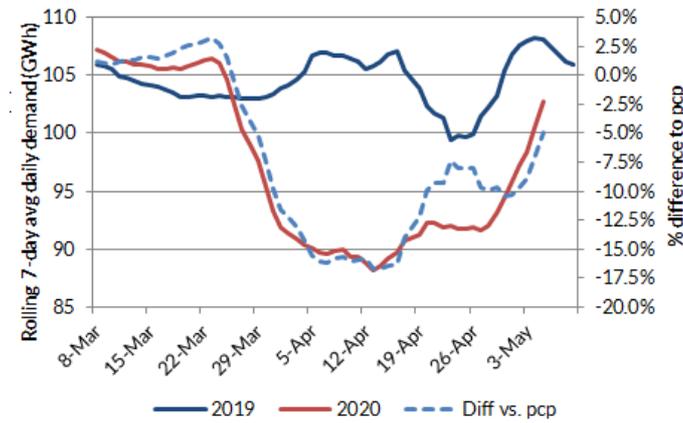
Demand analysis – what’s been happening since NZ went into lockdown?

Alert Level 4 demand was down ~-15% across the whole sector. However, segmental demand behaved differently, with all retailers reporting similar segment effects. The positive story came from residential demand increasing +10% to +15%. Small to medium enterprise (SME) was the segment most materially impacted by the lockdown, with demand dropping -40% to -45%. Large corporate and industrial demand was down ~-20%. It was also noticeable that towards the end of the Alert Level 4 electricity demand started to creep up as businesses prepared to move to a lower Alert Level.

After a week of Alert Level 3 there has been a clear increase in electricity demand, with demand down just ~-2% at the weekend and ~-5% overall, and the shutdown of potline 4 at NZAS only accounting for ~1% of demand. Tuesday 5 May, demand was one of the highest of 2020 so far, with North Island demand +5% more than pre-lockdown Tuesday (albeit the demand increase was driven by the first winter 2020 cold snap). As highlighted in the charts below, there is a clear upwards trend in demand.

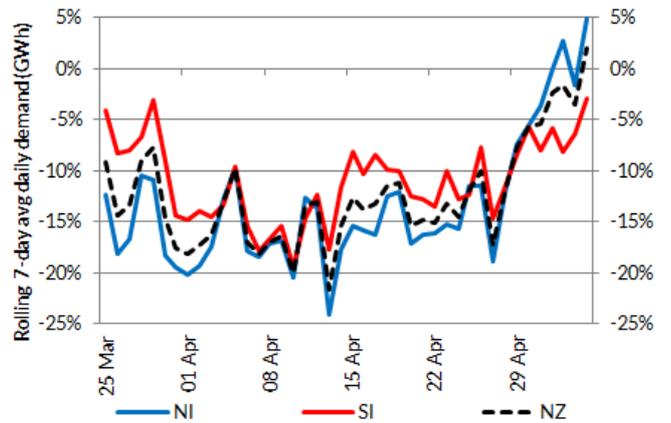
We expect electricity demand to continue to improve during Alert Level 3 and as the country moves to Alert Level 2 with many offices reopening at that stage. As discussed in more detail in our note *Electricity Sector – COVID-19's Modest Electric Shock*, published in March 2020, electricity demand did not decline during the GFC. Whilst it is still too early to say what the long-term impact will be from COVID-19, less than -2% appears to be a reasonable assumption at this stage i.e. largely immaterial.

Figure 11. NZ electricity demand vs. pcp – rolling 7-day average



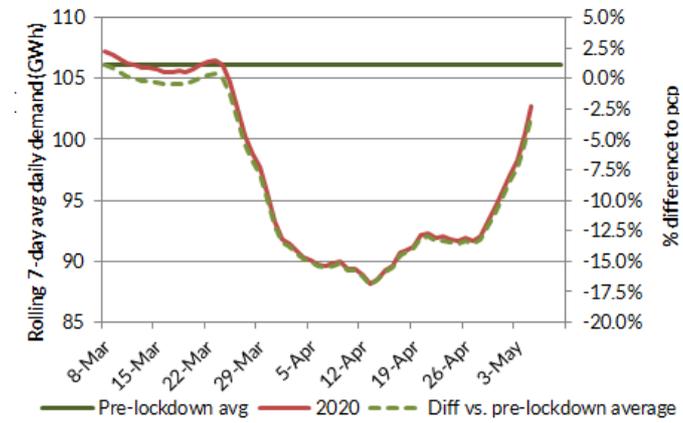
Source: EA, Forsyth Barr analysis

Figure 12. Daily variance to pre-lockdown electricity demand



Source: EA, Forsyth Barr analysis

Figure 13. NZ electricity demand vs. pre-lockdown demand – rolling 7-day average



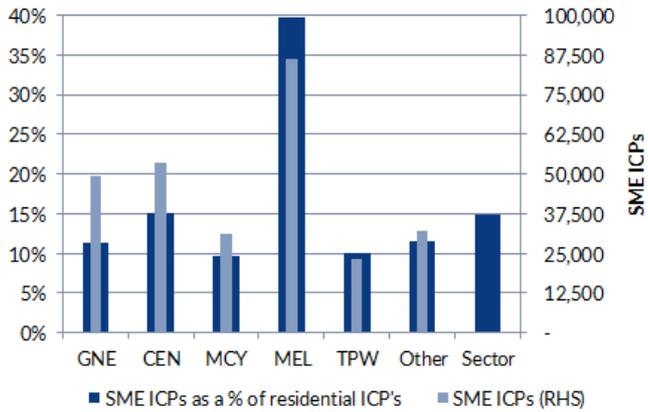
Source:EA, Forsyth Barr analysis

SME segment exposure

Most exposed to the SME segment is MEL. EA data indicates that ~40% of its residential connections are classified as SME, compared to ~15% for the sector as a whole. CEN has the next highest exposure at 15%, with MCY having the lowest exposure, with less than 10% of its residential connections classified as SME. MEL's SME market share is ~31% vs. ~12% share of residential connections overall.

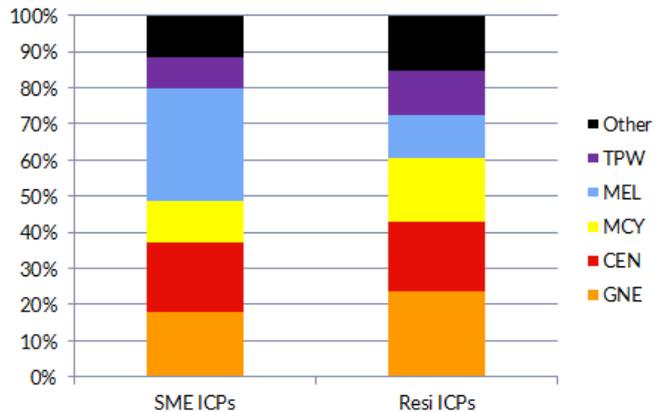
That said, MEL has been growing its retail book so quickly over the past two years our forecasts have tended to be behind its growth rate. In addition, MEL data indicates that over the past 12 months SME demand has been 25% of its mass market demand, with agricultural sales volumes almost 30%, reducing the overall demand impact from falling SME volumes. As a result, our forecast retail volume change has actually increased slightly.

Figure 14. SME connections vs. residential connections



Source: EA, Forsyth Barr analysis

Figure 15. Connection market share



Source: EA, Forsyth Barr analysis

Wholesale market effects – what’s been happening to wholesale electricity and ASX futures prices?

Spot wholesale electricity prices

Wholesale electricity prices have fallen to their lowest levels in three years, which is no surprise given the dramatic fall in electricity demand. The average wholesale electricity price at Otahuhu in April 2020 was \$48/MWh. In the context of low electricity demand and average hydro storage levels, that decline is not too dramatic and provides some clues to where wholesale electricity prices may fall to if NZAS were to close (after lower South Island transmission constraints have been removed but before the generation market has rebalanced).

ASX futures pricing

ASX futures prices have fallen dramatically, with short-dated ASX futures prices (the next 12-months) seemingly factoring in a significant impact on electricity demand. Benmore ASX futures prices are down ~\$20/MWh (~22%) to ~\$70/MWh and Otahuhu prices down ~\$30/MWh (~27%) to ~\$80/MWh from prices just before the lockdown announcement was made.

Long-dated ASX futures prices (2–3 years) have also declined but not to the same extent since New Zealand went into lockdown. Benmore prices are down ~\$3/MWh (-5%) to ~\$70/MWh and Otahuhu prices down ~\$8/MWh (-8%) to ~\$89/MWh. Long-dated prices had started falling from early March, with some in the market hedging against NZAS closure.

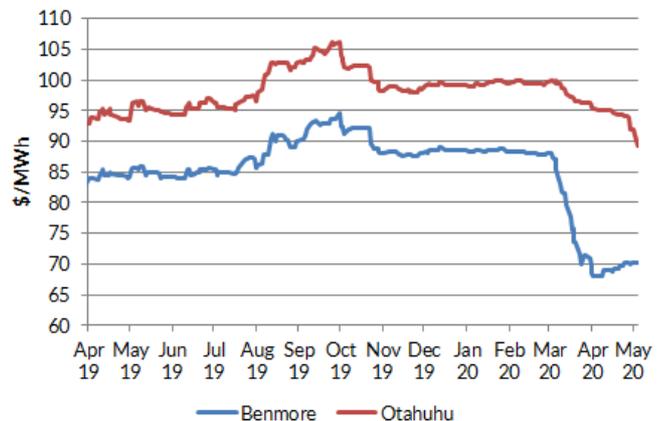
In our view, the long-dated Benmore ASX price falls are probably overdone. Whilst we had viewed the ASX prices as being too high, and well above the cost of new generation, the cost of new generation has increased over the past month due to the fall in the NZD vs. key currencies. The long-dated Otahuhu ASX fall is more reasonable and brings it back to where we would expect. The impact of the falling wholesale electricity futures outlook has reduced our longer-dated electricity forecasts, but not materially, as we had assumed electricity prices would not track as high as where the ASX futures prices had indicated in any case.

Figure 16. Short-dated ASX futures



Source: EA, Forsyth Barr analysis

Figure 17. Long-dated ASX futures



Source: EA, Forsyth Barr analysis

Generation mix favours renewables, reducing the cost of generation, but not as much as may have been expected

Whilst generation volumes fell -14% (-469GWh) vs. March 2020, hydro generation volumes were more than half of the decline and thermal generation volumes were surprisingly strong, down -182GWh, but April 2020 thermal generation was higher in November and December 2019. GNE ran the Rankine units more than we would have expected, and Unit 5 was also run constantly (highlighting GNE is still long gas).

That said, renewable generation was 87% of total generation in April 2020, comfortably above average (83% over the last five years) and geothermal generation had its biggest market share on record at 23.6%.

March 2020 quarter operating statistics

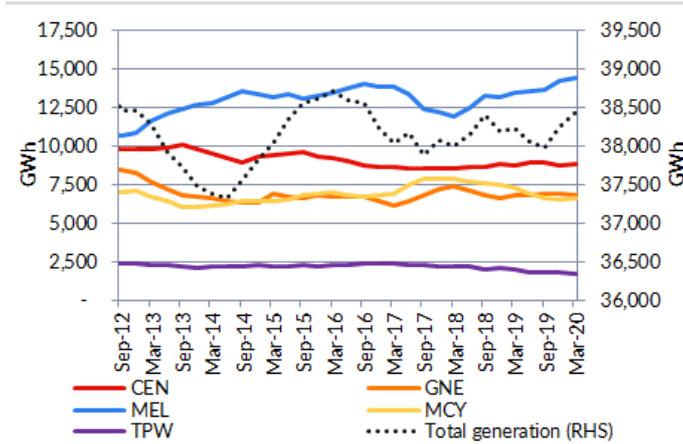
There was only one week of lockdown in the March 2020 quarter, so the impacts of COVID-19 cannot really be seen in the operating statistics. The period was characterised by HVDC maintenance work causing constraints on the interisland link and significant price separation between the islands, favouring North Island generators over South Island generators.

GNE probably had the best quarter, benefiting from the interisland price split and having a strong retail performance. MEL also had a strong quarter considering it was on the wrong side of the HVDC constraints.

Key take-outs:

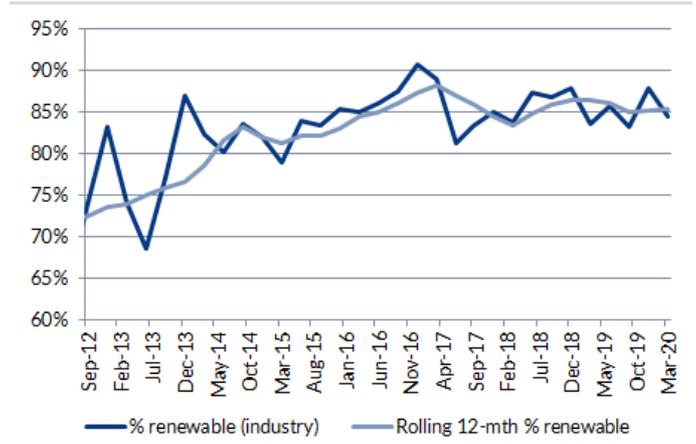
- Generation across the big five generators was up +2% on the pcp. The mix was broadly the same as the pcp, with renewable generation up +1% to 85% of total generation.
- Electricity prices were materially lower than the pcp due to more water (there was a heavy rainfall event in February). The price gap between MEL's average generation price received and GNE and MCY (North island generators) was a significant ~\$30/MWh (34%).
- MEL and GNE had strong retail performances, with MEL growing its book +20% and GNE +7% vs. pcp. CEN's retail sales volume fell -15% (-32% in the commercial market) as it was actively participating in that market for most of 2019.
- MEL is the only retailer actively growing its mass market retail customer numbers, adding +6,000 in the March 2020 quarter, with all other retailers flat or down on the prior quarter.
- The market is lifting retail prices, with all retailers except CEN reporting an increase in prices. The higher commercial prices in particular had a noticeable impact on MEL and MCY's average fixed price.

Figure 18. Rolling 12 month generation



Source: Company reports, Forsyth Barr analysis

Figure 19. Percentage of renewable generation



Source: Company reports, Forsyth Barr analysis

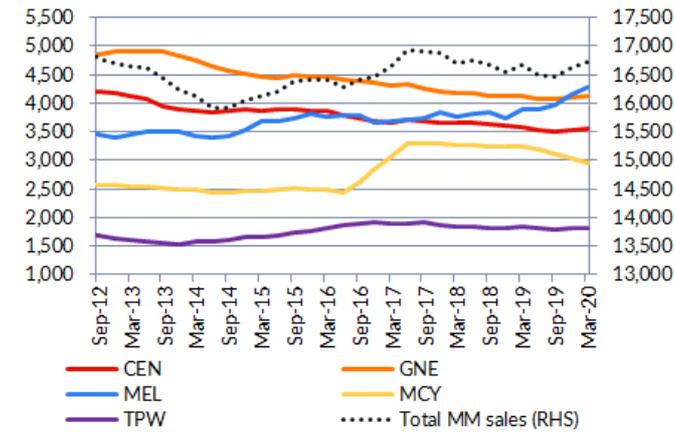
Figure 20. March quarterly stats summary

	Quarter ending Mar-19						Quarter ending Mar-20						% Change					
	CEN	GNE	MEL	MCY	TPW*	Total	CEN	GNE	MEL	MCY	TPW*	Total	CEN	GNE	MEL	MCY	TPW*	Total
Generation (GWh)																		
Hydro	966	482	3,083	762	338	5,631	965	419	3,257	839	287	5,767	0%	-13%	6%	10%	-15%	2%
Geothermal	761			710		1,471	829			708		1,537	9%			0%		4%
Wind		6	301		150	457		5	339		153	497	-17%	13%			2%	9%
<i>Total renewable</i>	1,727	488	3,384	1,472	488	7,559	1,794	424	3,596	1,547	440	7,801	4%	-13%	6%	5%	-10%	3%
Thermal generation	193	1,294				1,487	217	1,209				1,426	12%	-7%				-4%
TOTAL generation	1,920	1,782	3,384	1,472	488	9,046	2,011	1,633	3,596	1,547	440	9,227	5%	-8%	6%	5%	-10%	2%
% Renewable	90%	27%	100%	100%	100%	84%	89%	26%	100%	100%	100%	85%	-1%	-5%	0%	0%	0%	1%
GWAP (\$/MWh)	150.2	162.3	149.9	160.6	162.8	154.7	67.8	87.0	57.7	87.0	79.0	70.9	-55%	-46%	-62%	-46%	-51%	-54%
Electricity sales (GWh)																		
Mass market	715	845	1,038	679	364	3,641	740	872	1,172	602	371	3,757	3%	3%	13%	-11%	2%	3%
Commercial	786	527	608	350	219	2,490	531	598	805	409	185	2,528	-32%	13%	32%	17%	-16%	2%
TOTAL FPV sales	1,501	1,372	1,646	1,029	583	6,131	1,271	1,470	1,977	1,011	556	6,285	-15%	7%	20%	-2%	-5%	3%
Gas sales (PJ)	0.48	1.39			0.13	2.00	0.51	1.40			0.15	2.06	6%	1%			23%	3%
LPG (000 tonnes)		8.1				8.1		8.9				8.9		10%				10%
Customers added (000)																		
Electricity	3	(3)	3	(2)	(2)	(1)	(2)	(3)	6	(3)		(2)						
Gas	1	(0)			1	2	(1)	(1)			1	(1)						
LPG		1				1		1				1						
Customer numbers (000)																		
Electricity	409	499	300	379	267	1,853	408	494	320	353	266	1,841	0%	-1%	7%	-7%	0%	-1%
Gas	66	106		48	39	259	65	105		47	41	258	-2%	-1%		-2%	4%	-1%
LPG		67				67		72				72		8%				8%
MM volume/customer																		
Electricity (MWh)	1.8	1.7	3.5	1.8	1.4	2.0	1.8	1.8	3.7	1.7	1.4	2.0	3%	4%	6%	-5%	3%	4%
Gas (GJ/cust)	7.3	13.0			3.2	7.7	7.8	13.3			3.8	8.0	7%	2%			18%	4%
LPG (kg/cust)		121.8				121.8		124.1				124.1		2%				2%
FPV prices(\$/MWh)																		
Electricity	253.2	202.9	100.5	110.3			251.4	206.3	106.9	116.2			-0.7%	1.7%	6.4%	5.3%		
LWAP (\$/MWh)	160.6	162.9	157.5	169.0	163.7	162.0	74.6	79.3	65.2	88.3	80.8	75.5	-54%	-51%	-59%	-48%	-51%	-53%
LWAP/GWAP	1.069	1.004	1.051	1.052	1.006	1.047	1.101	0.911	1.130	1.015	1.023	1.065	3%	-9%	8%	-4%	2%	2%

Source: Company reports, Forsyth Barr analysis

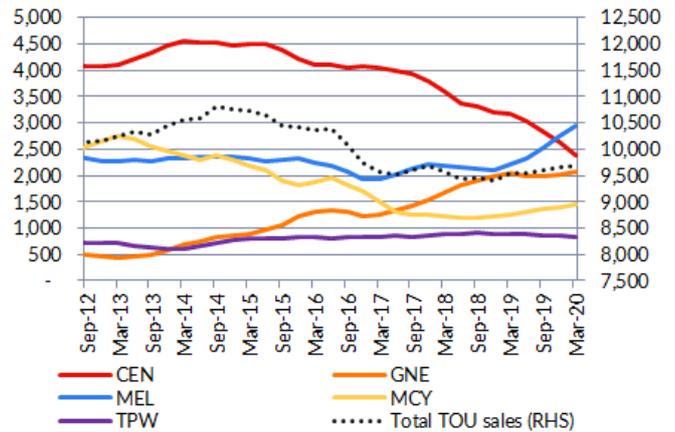
Note: TPW wind generation is Tilt Renewables generation

Figure 21. Mass market sales volumes (rolling 12 months)



Source: Company reports, Forsyth Barr analysis

Figure 22. Rolling 12 month commercial (time of use) sales



Source: Company reports, Forsyth Barr analysis

NZAS situation remains unresolved, but no change to our views

Rio Tinto's (RIO) initial announcement of a Strategic Review at NZAS indicated it wanted the review completed by the end of March 2020. That date came and went without any news. We were not surprised RIO has yet to announce a decision, particularly given the global pandemic which will be dominating management attention. We understand that MEL is still having conversations with RIO, however, there is no indication when a decision will be forthcoming. We retain our view that NZAS will remain open (albeit RIO may no longer be the owner).

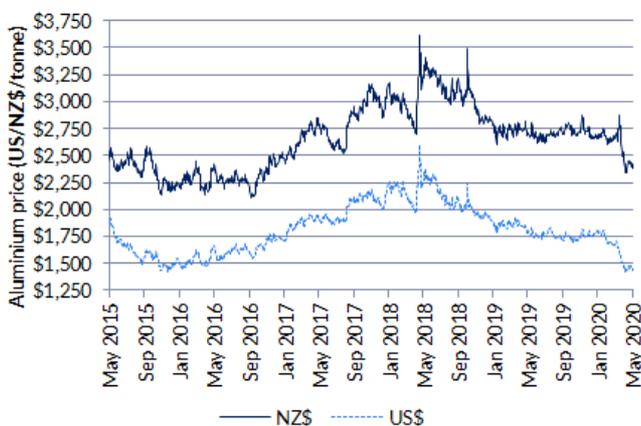
Profitability taking a hit, but RIO is making a long-term decision and it remains bullish on aluminium (publicly at least)

The headline aluminium price is not great. From pre COVID-19 levels of ~US\$1,750/tonne, the aluminium price is down -US\$300/tonne (-17%) to ~US\$1,450/tonne, the lowest level since the GFC. The price decline is understandable given all commodities are facing a negative demand shock, but temporarily turning off aluminium smelters is not practical. Hence, there is a significant increase in inventories. However, in NZD terms the price decline is less dramatic – ~11%, to ~NZ\$2,400/tonne the lowest NZD aluminium price since late-2016 (and the NZD aluminium price was lower than NZ\$2,400/tonne for most of the 2013 to late-2016 period).

In addition, alumina prices have also fallen providing an additional cushion to falling aluminium prices for NZAS. Profitability is better than it may appear on the surface. We estimate NZAS profitability (EBITDA less maintenance capex) is down ~NZ\$200/tonne and is negative. However, this is no worse than it was a year ago and is before any electricity price cut that we expect is coming.

Whilst not helpful, we do not believe the current operating environment will materially change RIO's thinking. Aluminium smelters are long-term assets and at its recent London Annual General Meeting (AGM) RIO indicated it is still bullish on the sector. Over time it expects supply to be removed from the market (in particular Chinese supply) which will rebalance the market. The current environment may be helpful in speeding up any market rebalancing.

Figure 23. Aluminium prices



Source: IRESS, Bloomberg, Forsyth Barr analysis

Figure 24. Aluminium-Alumina price spread



Source: IRESS, Bloomberg, Forsyth Barr analysis

Figure 25. NZAS profitability


Source: IRESS, Bloomberg, company reports, Forsyth Barr analysis

RIO continues to make positive decarbonisation comments – which is at odds with closing NZAS

The core reason we believe NZAS will remain open is it is a hydro-backed aluminium smelter, with 60% of global smelters coal-backed. Hydro generation is the best (and only realistic) form of renewable generation to support electricity hungry aluminium smelters, with other forms of renewable generation not well suited to providing a constant reliable flow of electricity. In addition, hydro generation is a scarce resource, which makes NZAS attractive in a decarbonising world.

RIO continues to make strong remarks regarding its environmental credentials, which in our view is at odds with closing NZAS. At its London AGM in early April, the RIO Chair commented (in answer to a question) that it is considering repowering its non-hydro Australian smelters with renewable energy. The cost of building sufficient wind/solar resource to run those smelters would not be dissimilar (subject to a suitable wind/solar resource being available nearby) to the electricity price being offered to NZAS at present and that's before the cost of firming the wind/solar generation (most likely fast-start gas plants) is factored in.

MEL and CEN transmission decision understandable – and don't read anything into it from an NZAS perspective

On Monday 3 May, MEL and CEN indicated that Transpower had sought additional funding to undertake work on the transmission upgrade between Clutha and the Upper Waitaki during summer 2020/21. Both MEL and CEN have indicated that they are not providing the funding sought. As a result it is unlikely that the project will be completed by June 2022 as hoped.

This project is the key project to enable hydro generation from MEL's Manapouri scheme and CEN's Clutha scheme to be transported north in the event NZAS were to close. The additional transmission capacity is not needed if NZAS remains.

We were always unclear how the project would get funded beyond this year if NZAS had not announced closure, as our understanding is Transpower cannot put a project like this into its regulatory asset base until it is needed, so it always appeared unlikely it would continue work without additional funding (or confirmation NZAS was closing). For MEL and CEN, the project costs ramp up materially after this year's enabling work, hence, the cost is harder to justify.

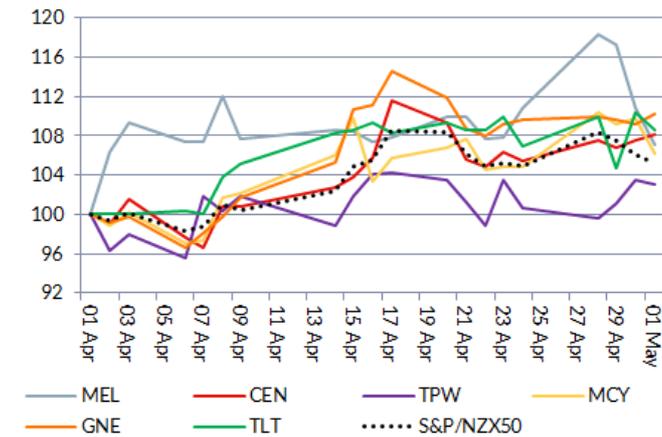
We do not see any significant issue with CEN and MEL's decision. If NZAS announces that it plans to close within the next three months, Transpower will restart the project quickly as it will become the highest priority transmission project in the country. Little time should be lost as the project can only be worked on during summer months. If NZAS announces it is staying (which we expect) it is also likely to provide additional certainty in the near-term (because we understand those are the conditions CEN and MEL are providing lower prices), removing one of the imperatives to get the transmission work completed ASAP.

We do not read anything from this decision with regard to RIO's NZAS Strategic Review.

Share market performance: April 2020

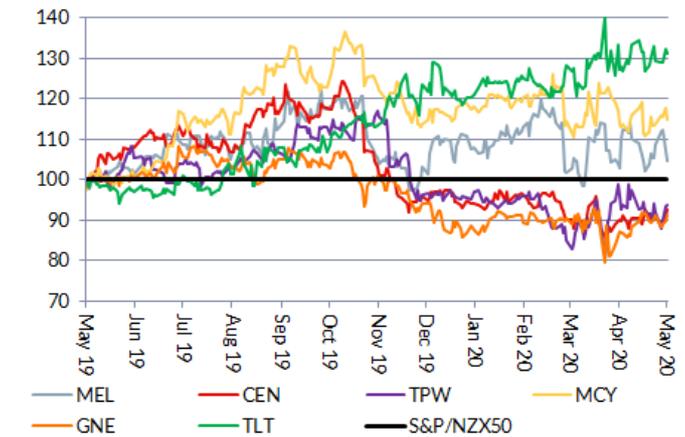
All of the electricity stocks increased in price in April 2020, as the New Zealand market experienced a large rally on the back of the sharp declines experienced in March. TPW was the only stock to lag behind the market, up +3% from 1 April to 1 May, vs the S&P/NZX50C which was up +5.3% over the same time period. GNE had the largest increase, up +10.3%, whilst CEN, MCY, MEL and TLT were up +8.2%, +6.3%, +7.2% and +8.6% respectively.

Figure 26. Stock performance vs. S&P/NZX50C



Source: Thomson Reuters, Forsyth Barr analysis

Figure 27. 12 month performance relative to S&P/NZX50C



Source: Thomson Reuters, Forsyth Barr analysis

Market multiples and target returns

- Our electricity target prices are based on a combination of our DCF valuation (30%), market multiples (30%) and gross dividend yield (40%). We focus on year two earnings to avoid short-term hydrological conditions impacting the multiples. We like the long-term outlook of the sector and maintain our view that NZAS will not be closing. In addition, we expect the market to turn to high quality yield stocks such as the electricity sector. We have an OUTPERFORM rating on all of the stocks.

Figure 28. EBITDAF multiples

Company	Code	Price	Target	Target	Rating	Mkt Cap \$m	EBITDAF (x)		EBITDAF - capex (x)	
			Price	Return			FY20	FY21	FY20	FY21
Contact Energy	CEN	\$6.22	\$8.15	37.3%	OUTPERFORM	4,451	12.4	11.6	15.1	13.8
Genesis Energy (excl Kupe)	GNE	\$2.86	\$3.30	21.5%	OUTPERFORM	2,571	14.0	12.2	17.2	14.6
Mercury	MCY	\$4.50	\$4.95	13.7%	OUTPERFORM	6,117	14.7	14.1	17.3	16.5
Meridian Energy	MEL	\$4.48	\$4.80	12.0%	OUTPERFORM	11,482	15.0	16.4	16.2	17.7
Trustpower	TPW	\$6.61	\$7.75	22.4%	OUTPERFORM	2,069	14.5	13.2	16.7	15.0
Sector average							14.1	13.4	16.5	15.5
Tilt Renewables	TLT	\$3.16	\$3.50	10.8%	OUTPERFORM	1,483	14.4	17.2	15.6	19.0
Genesis Energy (incl Kupe)	GNE	\$2.86	\$3.30	21.5%	OUTPERFORM	2,967	11.7	10.4	13.8	12.0

Source: Forsyth Barr analysis

Figure 29. PE multiples and dividend yields

Company	PE (x)		Adjusted PE (x)		Cash Div Yield		Gross Div Yield		Free Cash Flow Yield	
	FY20	FY21	FY20	FY21	FY20	FY21	FY20	FY21	FY20	FY21
Contact Energy	36.1	32.6	19.8	18.2	6.3%	6.3%	7.7%	7.9%	5.0%	6.2%
Genesis Energy (excl Kupe)	143.4	61.6	26.0	19.2	4.3%	4.8%	5.9%	6.5%	3.8%	5.8%
Mercury	45.6	36.6	26.7	23.2	3.5%	3.6%	4.9%	5.0%	1.2%	1.2%
Meridian Energy	35.7	43.5	22.7	25.8	4.8%	4.8%	6.0%	6.0%	3.9%	4.4%
Trustpower	28.1	23.4	24.6	20.9	5.1%	5.1%	7.1%	7.1%	2.6%	4.9%
Sector average	47.3	37.6	23.8	21.3	4.8%	4.9%	6.3%	6.5%	3.3%	4.5%
Tilt Renewables	11.0	13.0	18.1	22.9	0.0%	0.0%	0.0%	0.0%	3.0%	6.3%
Genesis Energy (incl Kupe)	83.6	43.0	18.7	15.0	6.0%	6.1%	8.1%	8.4%	5.9%	7.5%

Source: Forsyth Barr analysis

Note: In calculating the GNE excl Kupe multiples, the value of Kupe is assumed to be \$410m. Debt and interest has been apportioned 10% to Kupe and 90% to Energy (in line with EV proportion) and dividend in line with adjusted NPAT.

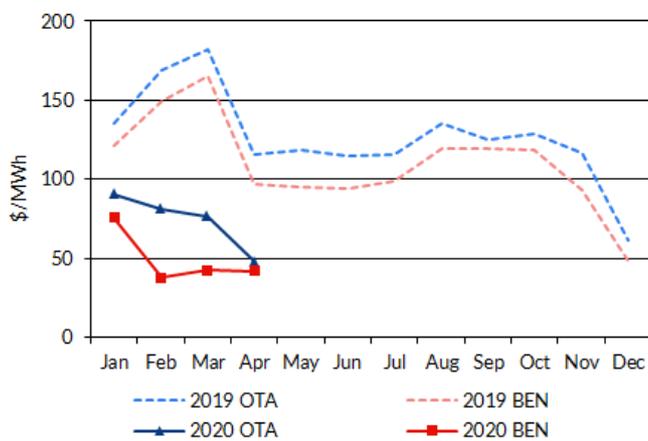
Wholesale electricity market: April 2020

Spot wholesale electricity prices and ASX futures

Price discrepancy between North and South disappears

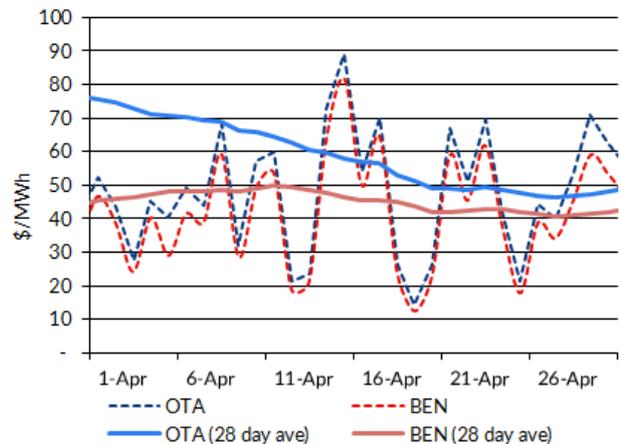
- The average Otahuhu (OTA) wholesale electricity price was \$48/MWh in April, down -58% on the pcp and down -37% from March. Benmore (BEN) wholesale prices were also down on the pcp, falling -57% to average \$42/MWh for the month, however, BEN prices were relatively unchanged from March 2020.
- The price gap between the North Island (OTA) and South Island (BEN) average wholesale electricity prices fell to ~\$6/MWh in April, having been \$34/MWh in March and \$43/MWh in February. This comes as the HVDC maintenance outages and constraints came to an end as well as the reduction in demand due to the nationwide lockdown.

Figure 30. Average monthly wholesale electricity prices



Source: NZX Energy, Forsyth Barr analysis

Figure 31. Average daily wholesale electricity prices



Source: NZX Energy, Forsyth Barr analysis

OTA futures fall in April

- BEN futures were largely unchanged over the month, with long-dated BEN futures up +0.5% and short-dated BEN futures up +1.5% over the month, to both finish the month at ~\$70/MWh.
- OTA futures were both down in April, likely due to the reduction in electricity demand from many of New Zealand's largest electricity consumers as they either had to reduce or stop operating during the nationwide Level 4 lockdown. OTA long-dated futures were down -4.1% to finish the month at \$92/MWh, while short-dated OTA futures were down -5.8% over the month to finish at \$80/MWh.

Figure 32. ASX futures prices (last three years)



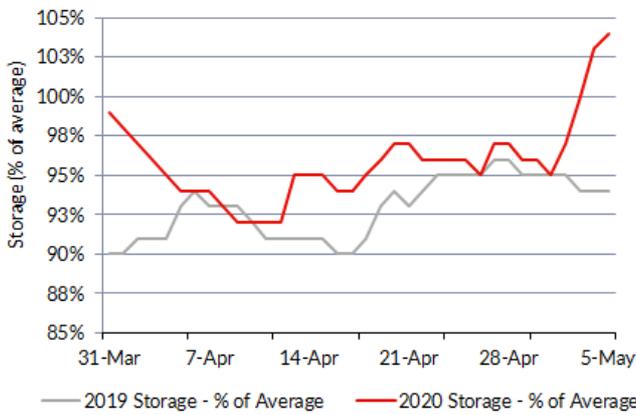
Source: Electricity Authority, Forsyth Barr analysis

Hydro storage volumes

Above average, just

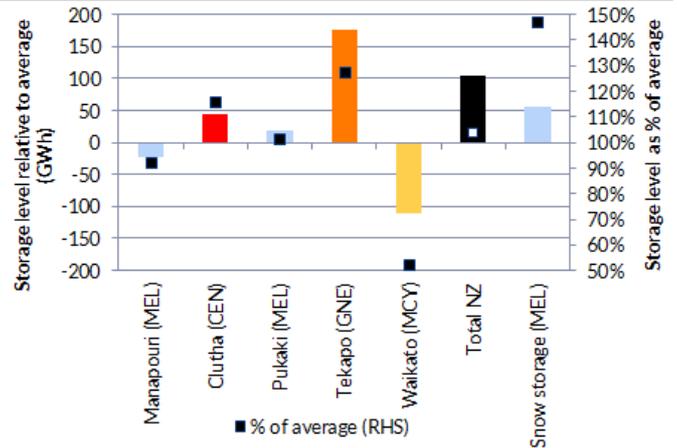
- As at 30 April, total New Zealand hydro storage levels were above average at 2,914GWh, +105GWh above average. MCY's Taupo storage continues to record the lowest level of storage vs average, currently at only 52%. MEL's Manapouri catchment is the only key South Island storage lake below average at 92%. All other storage lakes are comfortably up on this time of year. However, in early May there were heavy rainfalls increasing total lake storage levels to around ~104% of average.
- MEL snow storage was boosted by snow falls in the South in April and now sits at 174GWh, well above average for this time of year which is 118GWh.

Figure 33. Average lake storage levels



Source: NZX Energy, Forsyth Barr analysis

Figure 34. Key storage lake levels relative to avg (as at 30 Apr)



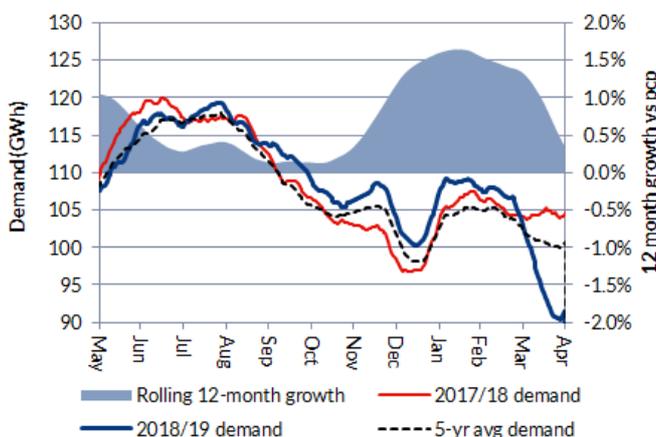
Source: EnergyLink, MEL, Forsyth Barr analysis

Demand and generation analysis

Demand feels impact of Covid-19

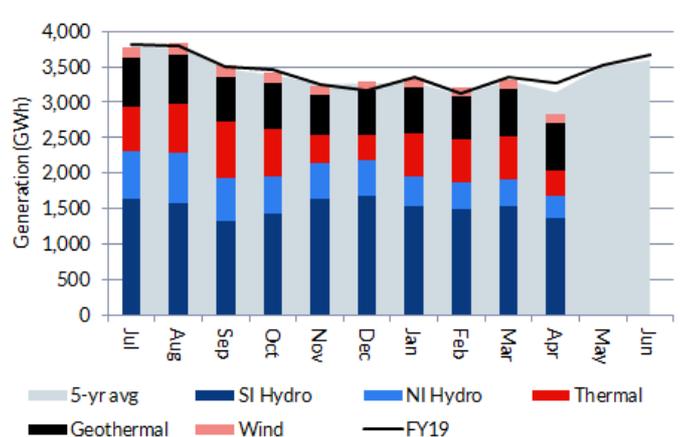
- Electricity demand for April 2020 averaged 91.4 GWh/day, down -13% on the pcp. This decrease is due to the reduction of electricity demand across the board as a result of the nationwide lockdown, with many companies ceasing operations whilst Alert Level 4 was in place. NZAS electricity demand also decreased -8% on the pcp and -6% from March, as a result of the closure of potline 4. The company did this to comply with social distancing measures during Level 4 lockdown, but was able to keep the rest of the plant operating having been deemed an essential service.
- Total New Zealand generation was 2,828GWh in February. This is ~14% decrease in generation on both the pcp and the prior month. All types of generation were down on the pcp, but it was Cogeneration which declined the most, down -48% on April 2019, which is due to industrial plants shutting down. Thermal, North Island hydro, and South Island hydro generation were down -35%, -4% and -15% respectively. The percentage of generation from renewables increased from 82% in March 2020, to 87% in April.

Figure 35. Rolling 28-day avg demand & rolling 12-m growth



Source: NZX energy, Forsyth Barr analysis

Figure 36. NZ generation (by technology) – fiscal year to June



Source: NZX energy, Forsyth Barr analysis

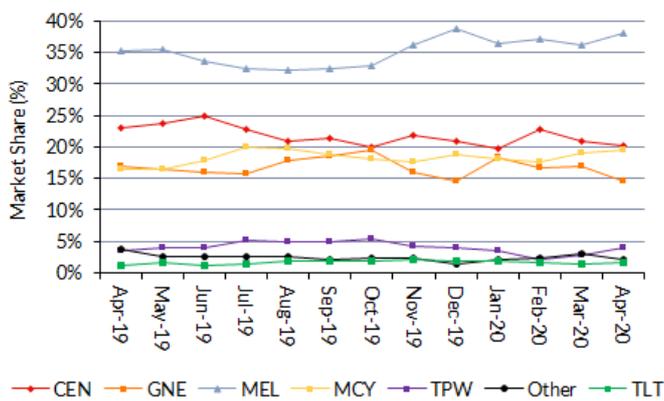
Generation market share – GNE loses share over April

- GNE lost -2.3% market share in April, generate 14.5% of total New Zealand generation for the month. MEL had a good month gaining +1.8% market share to reach over 38% of generation again, after having fallen below that level since December 2019. TLT, MCY and CEN were largely flat over the month whilst TPW gained an extra +1% market share in April.

CEN – Thermal and Hydro generation fall

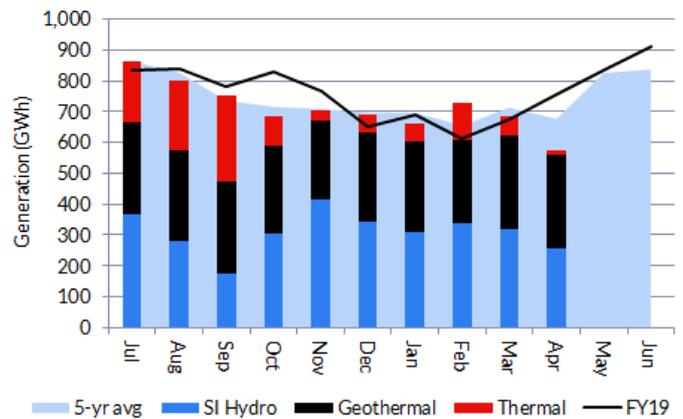
- Total CEN generation was down -24% on the pcp, to total 572GWh for April 2020. Hydro and thermal generation were both off significantly, down -84% and -33.5% on the pcp respectively. The decrease in thermal generation was due to both the TCC units not operating as well as the Stratford Peaker producing -76% less electricity than last April. CEN seems to be holding back water as its Clutha hydro plant was off significantly.

Figure 37. Monthly generation market share



Source: EnergyLink, Forsyth Barr analysis

Figure 38. CEN monthly generation mix (current, pcp & 5y avg)



Source: EnergyLink, Forsyth Barr analysis

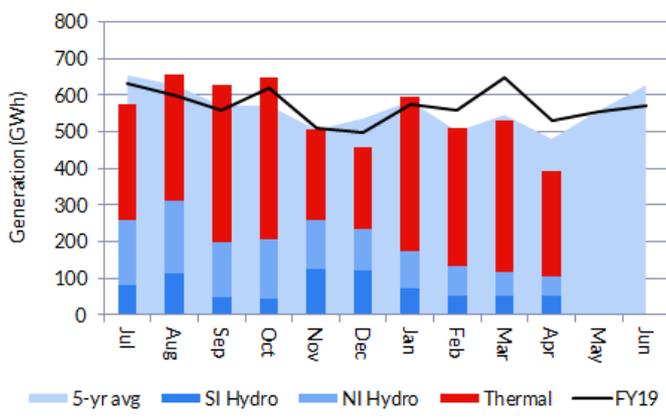
GNE – Thermal generation higher than expected

- GNE's generation was 410GWh in April 2020, which is a -26% decrease on April 2019. GNE's thermal generation was surprisingly high, with its Unit 5 having the highest daily average since April 2019. This indicates that GNE is still long gas and has ongoing take or pay contracts. GNE's hydro generation was also down -33% total 105GWh.

MCY – Generation flat despite lockdown

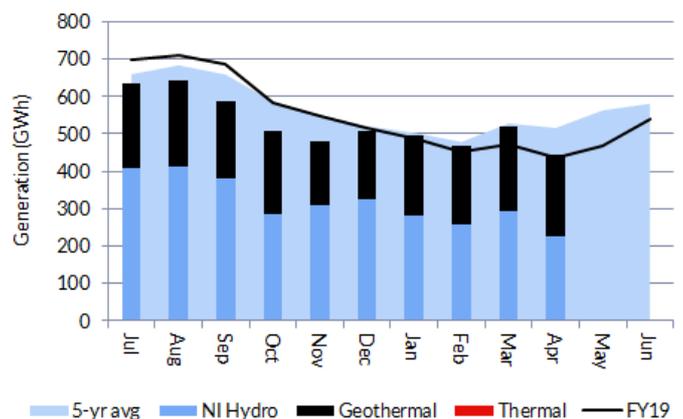
- MCY's April generation of 445GWh is down -14% on the prior month but was largely flat on the pcp (+2%). This is surprising given the current decrease in generation across the board due to the nationwide lockdown and the resulting decline in demand. MCY's Waikato hydro plant was up +2% on the pcp, whilst Geothermal generation was up by a similar amount, producing 220GWh.

Figure 39. GNE monthly generation mix (current, pcp & 5y avg)



Source: EnergyLink, Forsyth Barr analysis

Figure 40. MCY monthly generation mix (current, pcp & 5y avg)



Source: EnergyLink, Forsyth Barr analysis

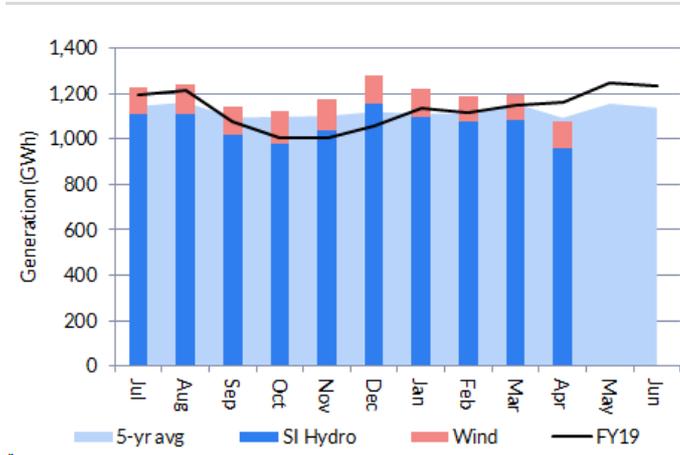
MEL – Holding back water

- MEL's hydro generation was 958GWh, this is down -10% on April 2019, and is MEL's lowest hydro generation since November 2018. This indicates that MEL is currently holding back water in light of the current environment. Wind generation was up +17% on April last year at 116GWh. Total April generation for MEL was 1,074GWh.
- MEL's hydro storage volumes are floating around average for this time of year.

TPW – Market share boost

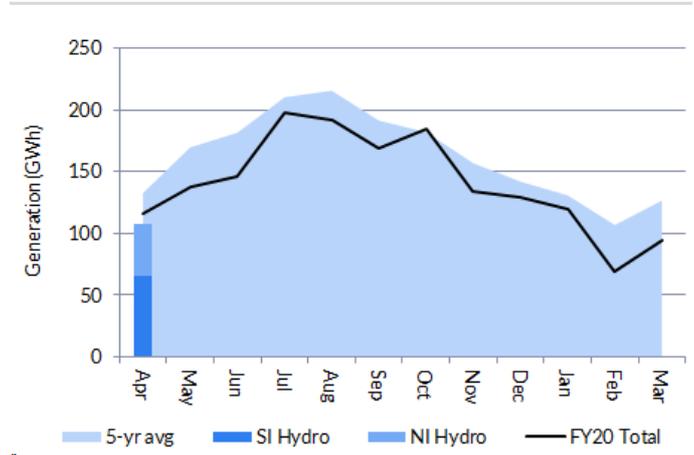
- We estimate that TPW generation was 108GWh in April 2020, which is a -7% decline from April 2020, but a +15% increase compared to prior month which helped TPW to gain an extra +1% generation market share over the month as generation declines across the board. This mom increase was largely due to TPW's South Island hydro increasing vs March generation numbers.

Figure 41. MEL monthly generation mix (current, pcp & 5y avg)



Source: EnergyLink, Forsyth Barr analysis

Figure 42. TPW monthly generation mix (current, pcp & 5y avg)



Source: EnergyLink, Forsyth Barr analysis

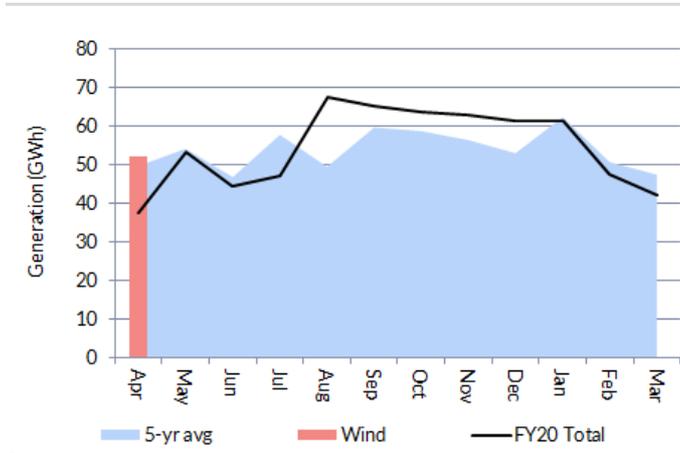
TLT – Wind bounces back

- Wind generation for TLT has bounced back following two months of decline to total 52GWh for April 2020, up +39% on the same time last year. TLT's average daily generation was also up +27% mom in April compared to March 2020.

Generation prices – GWAP down across all five big generator/retailers

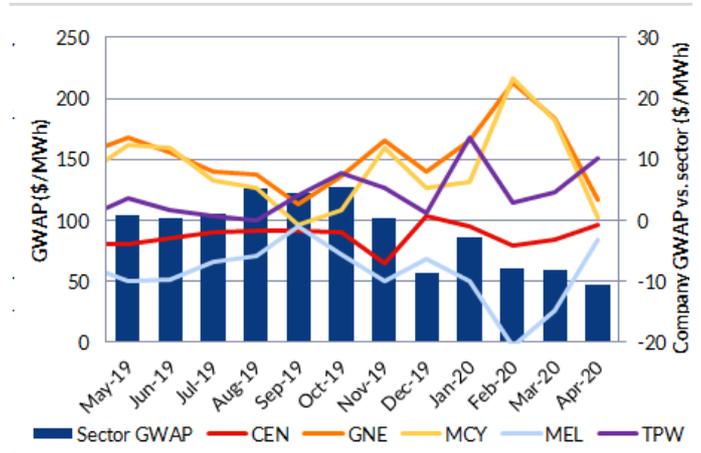
- The average generation weighted average price (GWAP) was \$47/MWh in April, which is down -11% from \$59/MWh in March 2020. All of the big five generators reported declines mom, however, MEL's GWAP declined the least, only down -2.4% to average \$43/MWh. MCY reported the largest decline, down -38% averaging \$47/MWh for the month. While GNE, TPW and CEN averaged \$50/MWh, \$57/MWh and \$46/MWh respectively.

Figure 43. TLT monthly generation mix (current, pcp & 5y avg)



Source: EnergyLink, Forsyth Barr analysis

Figure 44. Avg generation weighted average price (GWAP)



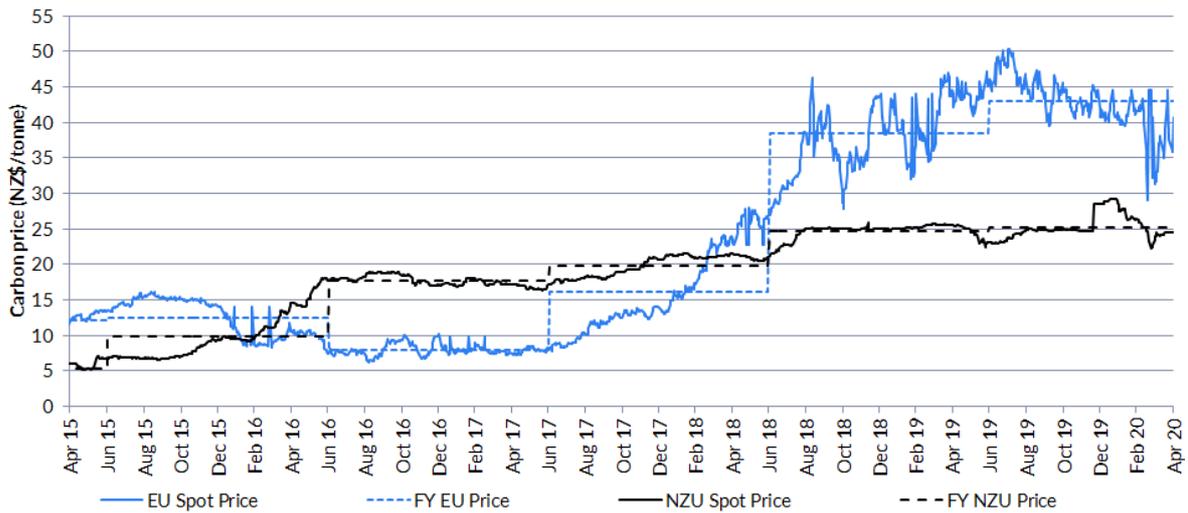
Source: EnergyLink, Forsyth Barr analysis

Carbon prices

NZ carbon prices — stable through April

- NZ carbon units were flat in April, ending the month at \$24.52/unit, after starting the month at \$24/unit, with the peak only slightly above at \$24.7/unit. This is well below the recent highs experienced of over \$29/unit after the Government's announcement that it would remove the unit price cap in December 2019.
- EU carbon units were up sharply in April, with a €6.4/unit (~NZ\$8/unit) increase from the beginning to the end of the month, to finish at €24.4/unit (NZ\$40.7/unit).

Figure 45. Price of carbon (NZ\$/tonne)



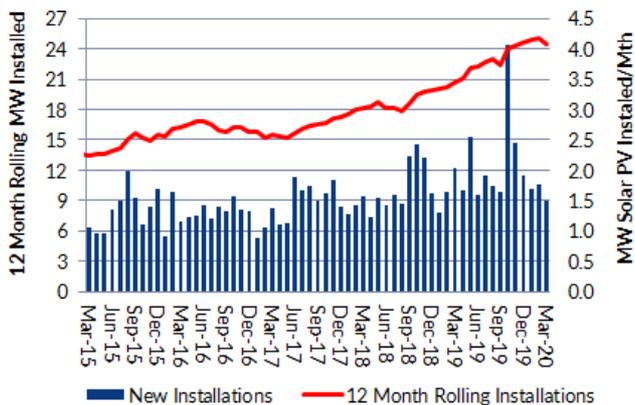
Source: Bloomberg, Forsyth Barr analysis

Solar PV installations

Rate of installation continues to decline

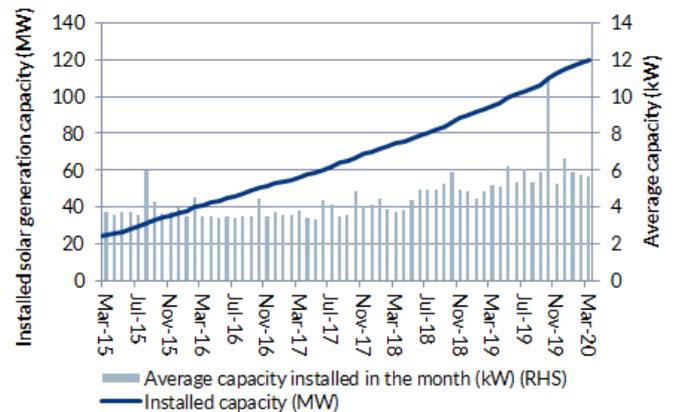
- There was 1.49MW of new solar capacity installed in March 2020, as the rolling 12month MW installed decreased to 24.5MW. The number of solar ICPs in the month was 233 in the month, down from 331 in February. The total capacity installed is now 116.95MW, with 26,958 solar ICP connections.

Figure 46. Solar PV capacity installed



Source: Electricity Authority, Forsyth Barr analysis

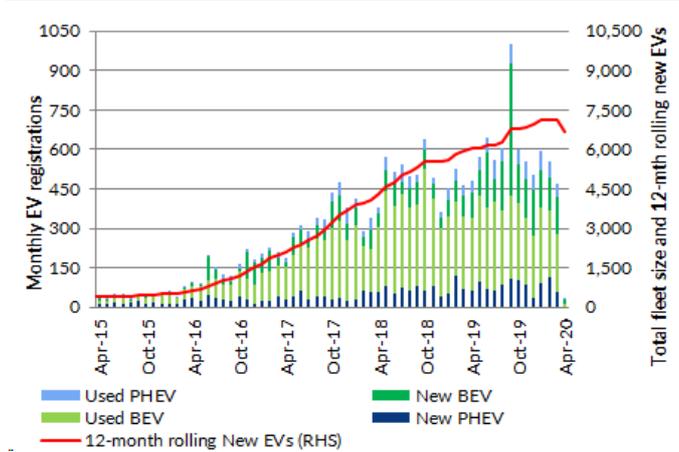
Figure 47. Average size of system and total capacity installed



Source: Electricity Authority, Forsyth Barr analysis

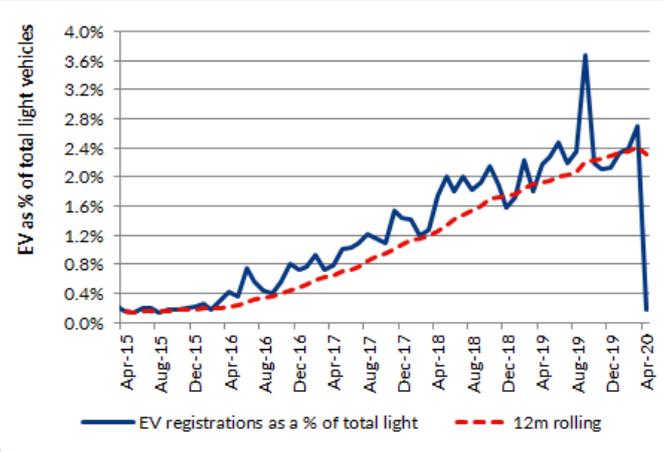
Electric vehicle (EV) registrations

Figure 48. EV registrations



Source: Ministry of Transport, Forsyth Barr analysis

Figure 49. EV registrations % of total light vehicle registrations

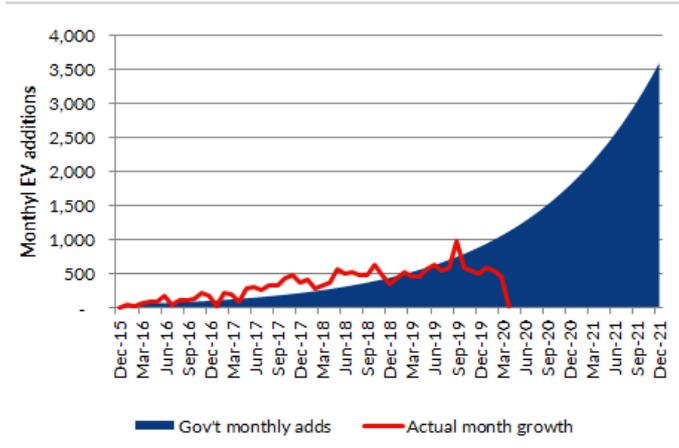


Source: Ministry of Transport, Forsyth Barr analysis

New EV registrations trending upwards

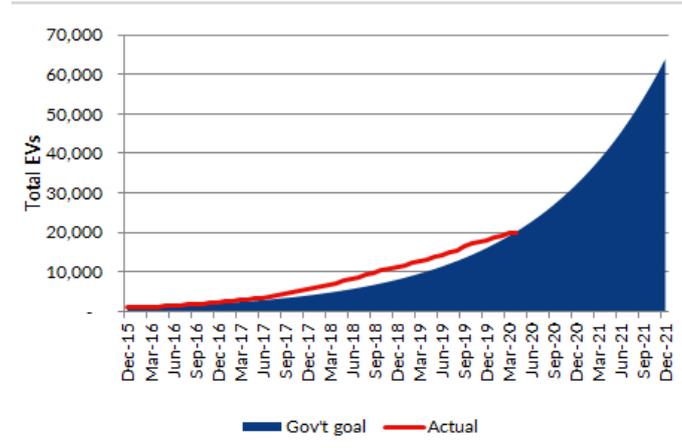
- April 2020 saw the number of EVs registered fall to just 32, down -93% on March 2020, which was already significantly lower than usual. This is the lowest number of EVs registered since August 2015.
- The number of EVs registered as a percentage of light vehicle registrations fell to 0.2%, after having averaged ~2% for the past 12 months. With many rental car companies now selling second hand rental vehicles cheap due to the lack of demand we may see this number remain depressed for a number of months.
- The number of EVs registered is now below the government target for the first time by ~400.

Figure 50. Monthly EV registrations vs. govt target



Source: Ministry of Transport, Forsyth Barr analysis

Figure 51. Total EVs registered vs. govt target



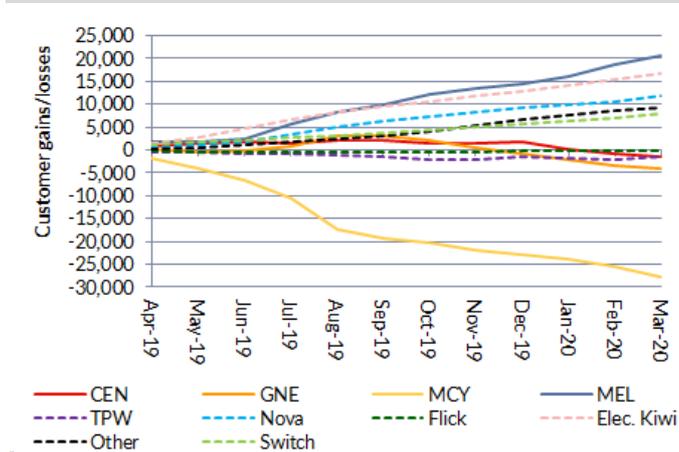
Source: Ministry of Transport, Forsyth Barr analysis

Retail electricity customers

Another good month for MEL

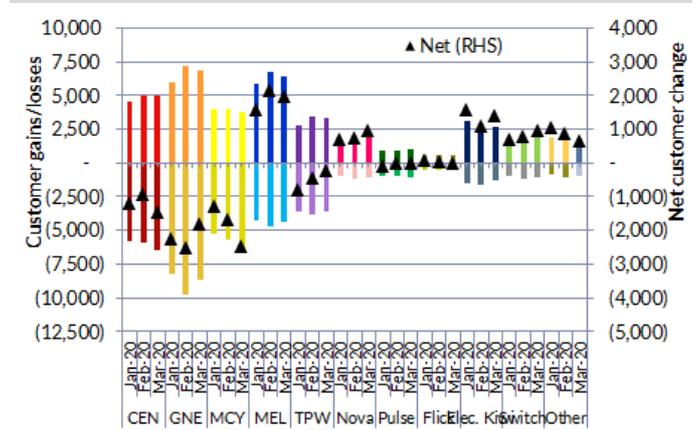
- MEL gained +2,035 connections in March, making it again the largest gainer of connections in the month. TPW was the only of the other big five generator retailers to add connections, with +688 extra in March. CEN, GNE and MCY lost -596, -642 and -2,313 respectively.
- All of the tier-2 retailers added connections over the month, but once again Electric Kiwi had the most success, gaining +1,393 additional connections.
- In March MEL was also the only large retailer to gain customers through switching (which excludes market growth), gaining +1,986 connections.

Figure 52. Cumulative 12-mth electricity customer gains/losses



Source: EA, Forsyth Barr analysis

Figure 53. Customer switches (excludes market growth)

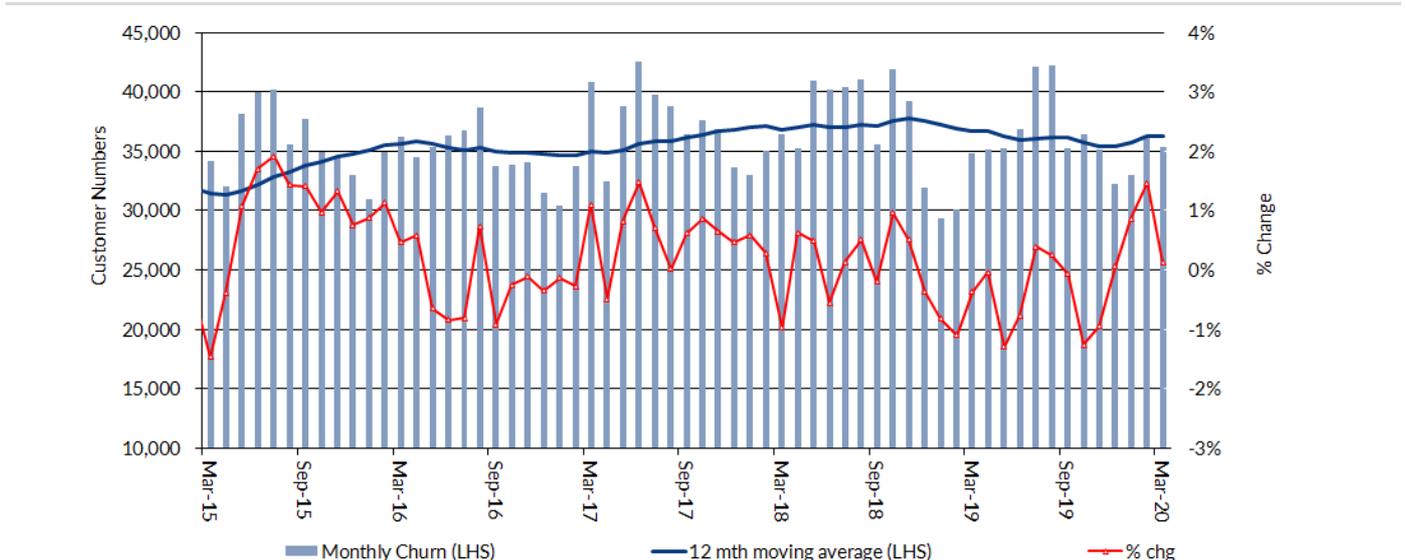


Source: EA, Forsyth Barr analysis

Connection churn

- There were ~35,400 customer switches over March 2020, which is largely in line with March last year, up only +1.6% on the pcp. However, this churn number is down -2.8% on February, which is unexpected as churn is usually down in the months between December and February and increases towards the middle of the calendar year.
- If the gas retail churn for April is repeated for the electricity, churn levels will almost halve with few able to move house during lockdown.

Figure 54. Electricity connection churn



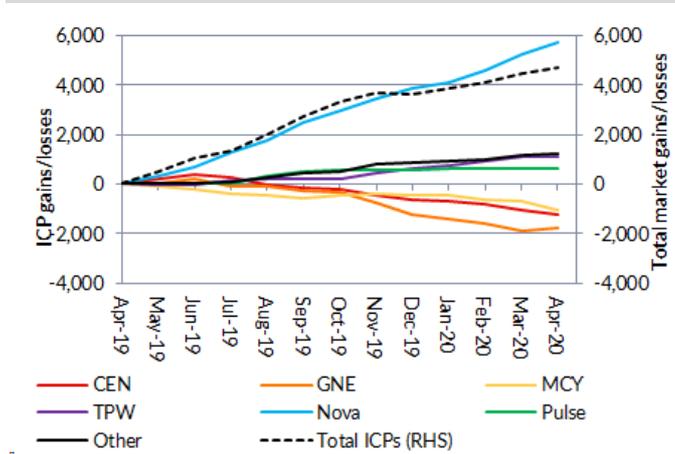
Source: EA, Forsyth Barr analysis

Retail gas customers

Nova's growth continues

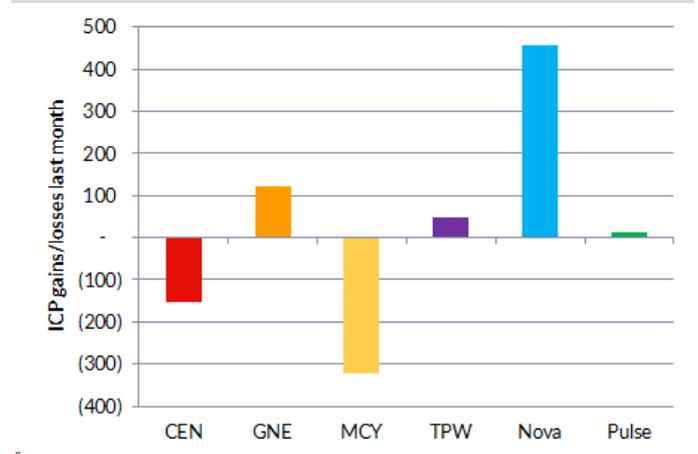
- Nova Energy added +456 gas connections in April 2020, which makes the number of new connections since April 2019 for the company +5,723. GNE had the best month of the listed gas providers, adding +123 connections in the month, whilst TPW also added +47 connections to continue its run of monthly additions. CEN and MCY lost -152 and -324 connections respectively.
- Since April 2019 TPW has added +1,138 connections, whilst CEN, GNE and MCY have all lost gas connections, down -1,203, -1,776 and -1,038 over the 12-month period respectively.
- Switching numbers between gas providers has fallen from 3,955 in March 2020 to 1,797 in April as a result of the nationwide lockdown. This is the lowest reported number of gas switches since early 2011.

Figure 55. Gas connection gains/losses over the past 12-months



Source: Gas Industry Co, Forsyth Barr analysis

Figure 56. Gas connection gains/losses in April 2020



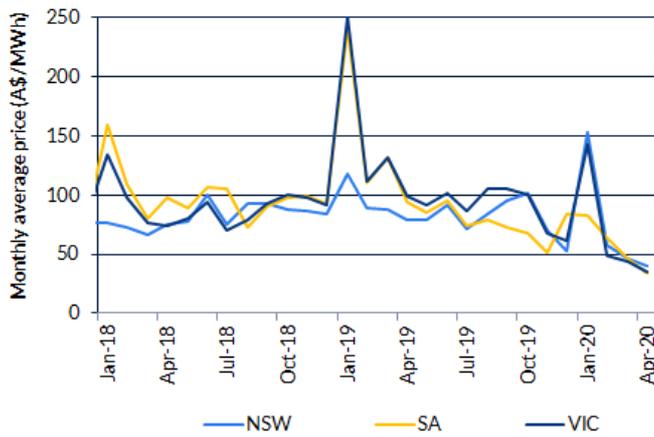
Source: Gas Industry Co, Forsyth Barr analysis

Australian electricity market

Wholesale electricity prices down sharply in lockdown

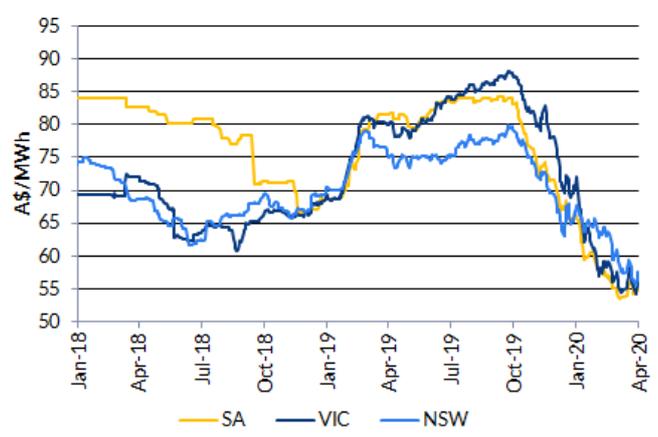
- NSW, SA and VIC wholesale electricity prices were all down sharply on the pcp, down -48%, -64% and -64% respectively. This decline in wholesale electricity prices is due to the decrease in energy demand in Australia as the country shuts down amid Covid-19 lockdown. VIC wholesale electricity prices averaged A\$35/MWh in April, which is the lowest recorded since December 2016.
- FY21 futures were all down in April compared to the prior month. NSW futures declined the most, falling by -5.6% to end the month at A\$57.5/MWh. SA and VIC futures were down -0.8% and -2.1% to end the month at A\$54.7/MWh and A\$56.4/MWh respectively.

Figure 57. Australian wholesale electricity price (A\$/MWh)



Source: AEMO, Forsyth Barr analysis

Figure 58. Australian FY21 futures prices (A\$/MWh)

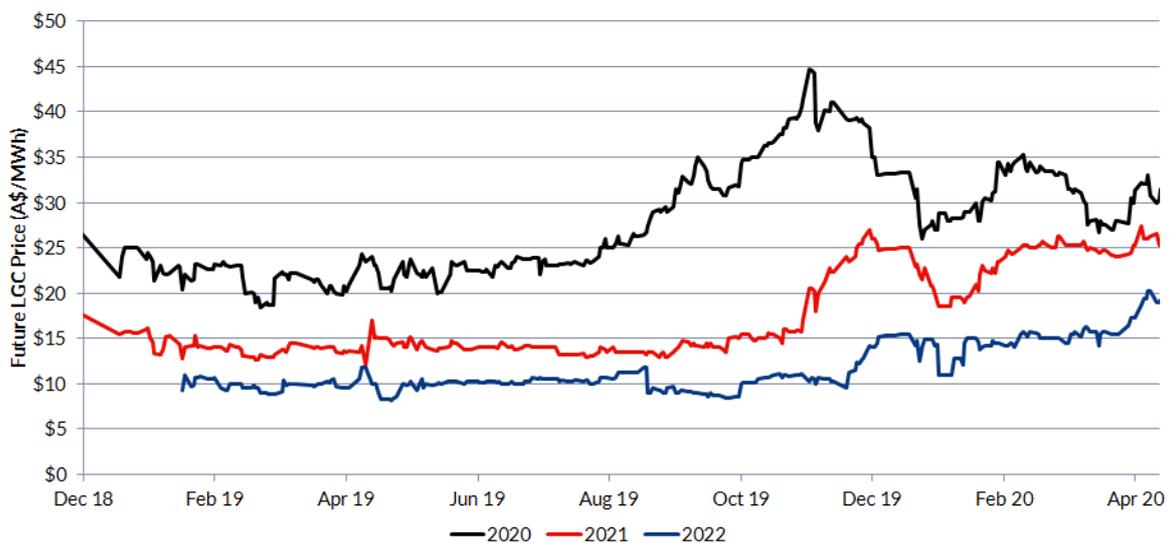


Source: Thomson Reuters, Forsyth Barr analysis

Renewable energy certificates (LGC) spot prices increase

- Spot LGC prices were down in February, ending the month at A\$31/MWh after starting the month at A\$27/MWh.
- Long-dated LGC futures were largely unchanged over the month increasing only A\$0.5/MWh to finish the month at A\$25/MWh. 2022 dated LGC prices increased the most over the month, up +29% from the start of the month to now sit at A\$18.3/MWh.

Figure 59. Renewable energy certificate prices (LGC)



Source: Bloomberg, Forsyth Barr analysis

Key statistics

New Zealand electricity market statistics

Figure 60. Key statistics – New Zealand

	Apr-19	Mar-20	Apr-20	% Chg pcp	% Chg mom
Average Monthly Prices					
OTA avg (\$/MWh)	\$ 115.2	\$ 76.6	\$ 48.0	-58.4%	-37.4%
HAY avg (\$/MWh)	\$ 103.1	\$ 72.6	\$ 44.3	-57.1%	-39.0%
BEN avg (\$/MWh)	\$ 96.8	\$ 42.3	\$ 42.1	-56.6%	-0.7%
Avg Daily Generation (GWh)					
CEN	25.2	22.1	19.1	-24.4%	-13.6%
% of NZ Generation	23.1%	20.8%	20.4%	-11.7%	-2.2%
GNE	18.4	17.8	13.7	-25.7%	-23.4%
% of NZ Generation	16.8%	16.8%	14.6%	-13.3%	-13.4%
MCY	18.0	20.2	18.4	2.2%	-9.2%
% of NZ Generation	16.5%	19.1%	19.6%	19.2%	2.7%
MEL	38.6	38.5	35.8	-7.3%	-7.1%
% of NZ Generation	35.3%	36.4%	38.2%	8.2%	5.1%
TPW	5.1	4.4	5.3	4.0%	21.3%
% of NZ Generation	4.7%	4.1%	5.7%	21.5%	37.2%
Daily Demand (GWh)					
Demand (excl Tiwai)	90.1	89.6	78.3	-13.1%	-12.7%
NZAS demand	14.4	14.1	13.2	-8.4%	-6.2%
Total NZ Demand	104.5	103.7	91.4	-12.5%	-11.8%
Hydrology (% of average)					
Average hydro inflows	82%	86%	80%	-2.9%	-7.9%
Average hydro storage	104%	107%	95%	-8.7%	-11.4%
Month end hydro storage	109%	99%	96%	-11.9%	-3.0%

Source: NZX Energy, EnergyLink, Thomson Reuters, Forsyth Barr analysis

Australian electricity market statistics

Figure 61. Key statistics Australia

	Apr-19	Mar-20	Apr-20	% Chg pcp	% Chg mom
Average Monthly Prices					
NSW avg (A\$/MWh)	\$ 78.5	\$ 46.2	\$ 40.5	-48.4%	-12.3%
SA avg (A\$/MWh)	\$ 93.8	\$ 47.0	\$ 33.7	-64.1%	-28.2%
VIC avg (A\$/MWh)	\$ 98.4	\$ 43.3	\$ 35.0	-64.4%	-19.1%
Electricity Futures for FY21:					
	30-Apr-19	31-Mar-20	30-Apr-20		
NSW avg (A\$/MWh)	\$ 75.4	\$ 60.9	\$ 57.5	-23.8%	-5.6%
SA avg (A\$/MWh)	\$ 81.6	\$ 55.2	\$ 54.7	-33.0%	-0.8%
VIC avg (A\$/MWh)	\$ 79.9	\$ 57.6	\$ 56.1	-29.8%	-2.6%
Spot and Future LGC Prices					
	30-Apr-19	31-Mar-20	30-Apr-20		
Spot (A\$/MWh)	\$ 40.0	\$ 27.0	\$ 30.3	-24.4%	12.0%
2020 (A\$/MWh)	\$ 24.0	\$ 26.8	\$ 31.6	31.5%	17.9%
2021 (A\$/MWh)	\$ 17.0	\$ 24.5	\$ 24.3	42.6%	-1.0%
2022 (A\$/MWh)	\$ 10.0	\$ 14.2	\$ 18.3	82.5%	29.0%

Source: Bloomberg, AEMO, Thomson Reuters, Forsyth Barr analysis

Industry news

Listed sector company news

Contact (CEN) & Meridian (MEL)

- Transpower's work on the Clutha-Upper Waitaki Lines Project (CUWLP), which will help move power from the South Island to the North Island, is likely to be delayed due to international supply chain disruptions as well as no more funding from CEN and MEL. CEN and MEL committed \$10m to the project late last year but would not commit more money after Transpower required extra funding for the project. The work was initially hoped to be completed by June 2022 but this may not happen, however, work already funded by CEN and MEL will continue until the end of June this year.

Mercury (MCY)

- MCY has again trimmed its guidance by \$10m and is now expecting earnings of \$490m for the year ending June, after cutting its guidance to \$500m in February. MCY has said that weaker hydro generation and possible consequences of Covid-19 are largely responsible for the cut.

Trustpower (TPW)

- TPW has decreased its 2020 full year guidance to an EBITDA range of between \$185m and \$195m, down from \$200m to \$215m. This is TPW's second guidance downgrade in three months. TPW attributes the downgrades to materially lower wholesale electricity prices, as well as a lower generation outlook for the remainder of the year.

Tilt Renewables (TLT)

- TLT has come to an agreement with ALDI foods that will see ALDI take ~6% of the production of TLT's Dundonnell wind farm over 10 years. This is the first PPA agreement TLT has had with an end user of the electricity.
- TLT is planning a \$267m share buyback following the sale of its Snowtown 2 wind farm. TLT has said it currently has a pipeline of ~3,000GWh, but the share buyback leaves plenty of cash for the firm to continue with its development pipeline. The buyback programme has now received initial orders from the high court, which will involve TLT organising a special meeting with shareholders. The buyback will see one in every five shares held cancelled for a price of \$NZ2.91.

Vector (VCT)

- Vector, along with First Gas and Powerco have proposed deferring network payments for retailers serving business customers to help support the businesses. The three distributors combine to supply ~96% of the natural gas customers in New Zealand, and they said it is up to each retailer to decide whether to take the offer and pass it through to customers.

Political / regulatory news

- The Electricity Authority (EA) has announced it is reducing its expectations of the net benefit of the transmission pricing methodology (TPM). The new expected benefits are around \$1.335b, with the given range between \$433m and \$2.432b, this estimate is down from the initial estimate of \$2.711b which was given when the proposed changes to the TPM were released last July.
- The EA has requested financial information from all power retailers that is now being assessed by an independent consultancy as the regulator seeks to better understand the issues facing retailers.
- The EA has released a consultation paper on the possible future of futures market making in New Zealand. There are six options outlined: the current voluntary model between the ASX and GNE, MEL, MCY, and CEN, a mandatory back-stopped voluntary approach, voluntary and mandatory commercial models, a mandatory commercial approach, a mandatory approach with transferable providers, and a mandatory approach.

Other industry news

- Kea Energy has said it plans to finish a 2MW solar farm in the Wairau valley in Marlborough by Christmas. The facilities generation will initially be limited to 1.85MW, however, the solar inverter being used for the project has the capacity to deliver up to 2.125MW. The estimated cost for the project is between \$2.5m and \$3.5m.

Contact Energy

Minor COVID-19 Symptoms

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

OUTPERFORM

Whilst the electricity sector is facing some COVID-19 headwinds, they are relatively minor and the earnings impact on Contact Energy's (CEN) EBITDAF is ~-2.2% over the next two years. Early indications are encouraging that electricity demand will return close to normal, meaning the greatest downside risk is from bad debts. With the impact of COVID-19 and subsequent economic downturn expected to be minor relative to other sectors, we expect the electricity sector to benefit from the lower interest rate environment. We have increased our target multiples and lowered our target dividend yield, resulting in a modest increase (+15cps to \$8.15) in our target price. We retain our OUTPERFORM rating.

Figure 1. What's changed:

FY20/FY21 EBITDAF: Lowered -\$10m/-\$10m (-2.3%/-2.2%) to \$431m/\$463m respectively
Target price: Increased +15cps (+1.9%) to \$8.15

NZX Code	CEN	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$6.22	NPAT* (NZ\$m)	277.5	224.5	243.9	249.4	EV/EBITDA	10.8	12.5	11.7	11.4
Target price	NZ\$8.15	EPS* (NZc)	38.8	31.4	34.1	34.8	EV/EBIT	17.9	24.9	22.7	22.9
Risk rating	Low	EPS growth* (%)	21.4	-19.1	8.6	2.3	PE	16.0	19.8	18.3	17.8
Issued shares	715.5m	DPS (NZc)	39.0	39.0	39.0	39.0	Price / NTA	1.9	2.0	2.2	2.3
Market cap	NZ\$4,451m	Imputation (%)	64	59	65	65	Cash div yld (%)	6.3	6.3	6.3	6.3
Avg daily turnover	1,088k (NZ\$7,966k)	*Based on normalised profits					Gross div yld (%)	7.8	7.7	7.9	7.9

Trading outlook slightly softer, but not materially so

We have trimmed our outlook for CEN with several factors impacting our forecast including: lower wholesale electricity price outlook, modest fall in FY20 electricity demand (due in part to lower sales volumes than expected in February and March), increased risk of bad debts in FY21. We have also pushed back the likely construction of Tauhara a year, which has a minor impact on FY22 earnings. We discuss the wholesale market outlook and assumptions changes in more detail in the May 2020 edition of Power Points.

Small risk that dividend will get trimmed on lower earnings, but CEN will be reluctant to do so

We have left our dividend forecast unchanged at 39cps, consistent with CEN guidance. However, we believe it will now be harder for CEN to achieve underlying EBITDAF earnings of \$480m (which we did not expect until FY22). The lower wholesale electricity price outlook will impact on the price commercial customers are being signed up on and FY21, in particular, is likely to be impacted by an increase in bad debts. Whilst earnings of \$480m implies a slightly higher dividend than 39cps, a \$20m decline in EBITDAF equates to ~2cps in dividend.

Lifting sector outlook as defensive nature of electricity is increasingly attractive

Whilst our near-term earnings outlook is slightly softer, we believe that the electricity sector is becoming increasingly attractive relative to other market opportunities. Thinking beyond COVID-19, we expect investments that offer a robust dividend will be sought after. Traditional stocks that were previously viewed as safe havens, such as property, SkyCity and airports, face greater downside issues than the electricity stocks. We have, therefore, lowered our target gross dividend yield (-0.5% to 5.75%) and lifted our target multiples modestly (adjusted PE up +2x to 24x), which has the effect of offsetting our modest earnings cuts and lifting our target price +15cps (+1.9%) to \$8.15.

Contact Energy Limited (CEN)

Priced as at 06 May 2020 (NZ\$)

6.22

12-month target price (NZ\$)*						Spot valuations (NZ\$)					
Expected share price return						1. DCF					7.37
Net dividend yield						2. Market multiples					8.01
Estimated 12-month return						3. Dividend yield					8.80
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						Total firm value					6,541
Equity beta						(Net debt)/cash					(1,197)
WACC						Less: Capitalised operating leases					
Terminal growth						Value of equity					5,344
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Sales revenue	2,275.0	2,519.0	1,945.2	2,032.0	2,112.5	EV/EBITDA (x)	12.4	10.8	12.5	11.7	11.4
Normalised EBITDA	479.0	518.0	431.4	462.8	474.0	EV/EBIT (x)	22.5	17.9	24.9	22.7	22.9
Depreciation and amortisation	(220.0)	(205.0)	(215.5)	(224.2)	(237.2)	PE (x)	19.5	16.0	19.8	18.3	17.8
Normalised EBIT	264.0	313.0	215.8	238.6	236.8	Price/NTA (x)	1.9	1.9	2.0	2.2	2.3
Net interest	(84.0)	(70.0)	(56.6)	(55.0)	(57.2)	Free cash flow yield (%)	6.7	7.6	5.1	6.2	3.5
Depreciation capex adjustment	96	102	110	112	120	Net dividend yield (%)	5.1	6.3	6.3	6.3	6.3
Tax	(48.0)	(72.0)	(45.2)	(51.4)	(50.3)	Gross dividend yield (%)	6.1	7.8	7.7	7.9	7.9
Minority interests	0	0	0	0	0						
Adjusted normalised NPAT	228.6	277.5	224.5	243.9	249.4	Capital Structure					
Abnormals/other	(94)	67	(108)	(112)	(120)	Interest cover EBIT (x)	3.4	4.9	4.2	5.0	5.0
Reported NPAT	135.0	345.0	116.1	132.2	129.3	Interest cover EBITDA (x)	5.7	7.4	7.6	8.4	8.3
Normalised EPS (cps)	31.9	38.8	31.4	34.1	34.8	Net debt/ND+E (%)	34.1	24.8	27.0	28.1	31.8
DPS (cps)	32.0	39.0	39.0	39.0	39.0	Net debt/EBITDA (x)	2.9	1.8	2.3	2.1	2.3
Growth Rates						Key Ratios					
Revenue (%)	9.4	10.7	-22.8	4.5	4.0	Return on assets (%)	5.0	9.8	4.5	5.1	5.1
EBITDA (%)	-4.4	8.1	-16.7	7.3	2.4	Return on equity (%)	4.9	6.3	4.4	5.3	5.5
EBIT (%)	-11.4	18.6	-31.0	10.5	-0.8	Return on funds employed (%)	4.6	9.5	4.4	5.0	5.0
Normalised NPAT (%)	9.0	21.4	-19.1	8.6	2.3	EBITDA margin (%)	21.1	20.6	22.2	22.8	22.4
Normalised EPS (%)	9.0	21.4	-19.1	8.6	2.3	EBIT margin (%)	11.6	12.4	11.1	11.7	11.2
Ordinary DPS (%)	23.1	21.9	0.0	0.0	0.0	Capex to sales (%)	3.6	2.5	4.6	3.2	10.2
						Capex to depreciation (%)	37	31	41	29	91
						Imputation (%)	48	64	59	65	65
						Pay-out ratio (%)	100	101	124	114	112
Cash Flow (NZ\$m)						Operating Performance					
EBITDA	479.0	518.0	431.4	462.8	474.0	Hydro generation (GWh)	3,479	4,232	3,771	3,887	3,887
Working capital change	37.0	(20.0)	(10.1)	(6.0)	14.8	Geothermal generation (GWh)	3,323	3,257	3,331	3,324	3,324
Interest & tax paid	(110.0)	(111.0)	(106.0)	(114.9)	(116.1)	Thermal generation (GWh)	1,812	1,422	1,139	1,208	1,379
Other	(27.0)	14.0	0	0	0	Total Generation (GWh)	8,614	8,911	8,241	8,418	8,589
Operating cash flow	379.0	401.0	315.3	341.9	372.7	GWAP (\$/MWh)	85	129	84	84	83
Capital expenditure	(82.0)	(63.0)	(89.0)	(65.0)	(216.3)	Gas consumed (PJ)	17.5	13.9	10.9	11.4	12.9
(Acquisitions)/divestments	6.0	382.0	0	0	0	Gas price (\$/GJ)	6.1	7.1	7.5	8.0	8.1
Other	(7.0)	0	0	0	0						
Funding available/(required)	296.0	720.0	226.3	276.9	156.4	Retail electricity volumes (GWh)	6,997	6,554	5,667	5,973	6,211
Dividends paid	(201.0)	(251.0)	(279.1)	(279.1)	(279.1)	Electricity customers (000)	413	411	407	405	403
Equity raised/(returned)	1.0	0	0	0	0	Average usage/customer (MWh)	8.7	8.6	8.6	8.6	8.6
(Increase)/decrease in net debt	96.0	469.0	(52.9)	(2.2)	(122.7)	Average retail price (\$/MWh)	242	244	245	250	255
Balance Sheet (NZ\$m)						LWAP (\$/MWh)	91	138	92	91	90
Working capital	(22.0)	(3.0)	6.1	11.2	(4.6)	LWAP/GWAP	1.07	1.07	1.10	1.08	1.08
Fixed assets	4,221.0	4,094.0	3,971.5	3,816.2	3,799.4	Retail gas volumes (PJ)	2.9	3.1	3.1	3.1	3.2
Intangibles	441.0	425.0	425.0	425.0	425.0	Gas customers (000)	65	67	66	66	66
Right of use asset	32.0	32.0	32.0	32.0	32.0	Average gas sales price (\$/GJ)	24.6	23.6	23.9	24.8	25.2
Other assets	404.0	132.0	132.0	132.0	132.0						
Total funds employed	5,076.0	4,680.0	4,566.6	4,416.4	4,383.7						
Net debt/(cash)	1,410.0	918.0	970.9	973.1	1,095.9						
Lease liability	38.0	25.0	25.0	25.0	25.0						
Other liabilities	901.0	955.0	946.8	933.1	917.0						
Shareholder's funds	2,727.0	2,782.0	2,623.9	2,485.2	2,345.8						
Minority interests	0	0	0	0	0						
Total funding sources	5,076.0	4,680.0	4,566.6	4,416.4	4,383.7						

Summary forecast changes

Figure 2. Summary forecast changes

	FY20			FY21			FY22		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	2,168	1,945	-10.3%	2,229	2,032	-8.8%	2,246	2,112	-5.9%
EBITDAF	441	431	-2.3%	473	463	-2.2%	490	474	-3.3%
EBIT	226	216	-4.4%	245	239	-2.5%	247	237	-4.1%
Reported NPAT	124	116	-6.0%	134	132	-1.4%	128	129	0.6%
Normalised NPAT	122	115	-6.1%	134	132	-1.4%	128	129	0.6%
Adjusted NPAT	232	224	-3.2%	249	244	-2.0%	253	249	-1.3%
EPS	32.4	31.4	-3.2%	34.8	34.1	-2.0%	35.3	34.9	-1.3%
DPS	39.0	39.0	0.0%	39.0	39.0	0.0%	39.0	39.0	0.0%
Generation (GWh)	8,718	8,241	-5.5%	8,910	8,418	-5.5%	9,420	8,589	-8.8%
Electricity Wholesale Price (\$/MWh)	\$104.5	\$84.1	-19.5%	\$100.6	\$84.4	-16.0%	\$88.3	\$83.3	-5.6%
Retail Demand (GWh)	5,888	5,667	-3.8%	6,121	5,973	-2.4%	6,370	6,211	-2.5%

Source: Forsyth Barr analysis

Investment Summary

Our rating is **OUTPERFORM**. Notwithstanding another challenging year, we view CEN as offering some of the best value amongst the generator/retailers. We believe the NZAS closure risk is more than priced into the share price. CEN is offering an attractive dividend yield and has one of the best potential development projects (Tauhara) in the country.

Key drivers

- **Wholesale electricity prices and the electricity demand/supply balance:** The wholesale electricity price is the key driver of retail and commercial prices and therefore the key value driver. The electricity demand/supply balance and the cost of new generation underpin the wholesale price. Currently the NZ market is balanced.
- **Retail margins:** In recent years intense retail competition and new entrant retailers have eroded retail margins. Strong margins support profitability.
- **Hydrology:** Short-term earnings are impacted by hydrology. CEN prefers wet conditions as it lowers its average cost of generation. However, CEN's thermal fleet provides it with some downside protection from dry conditions.

Other key company and industry issues

- **Increased carbon costs:** Following changes to the Emissions Trading Scheme, CEN has to relinquish more carbon credits, and carbon prices have increased materially. This is a modest headwind for FY20.

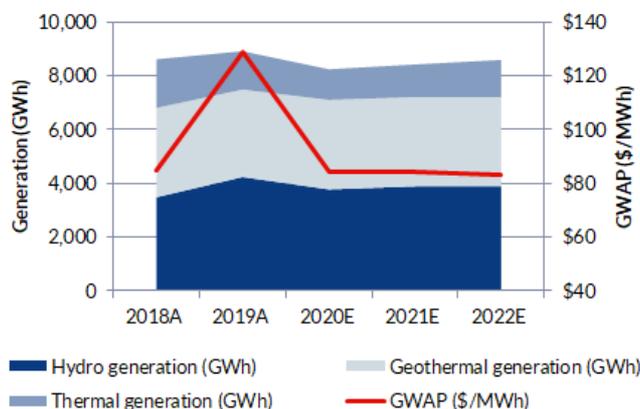
Upcoming catalysts/events

- **Geothermal development:** CEN has one of the best generation development opportunities in its Tauhara geothermal field. With modest electricity demand growth expected and CEN likely to close its base-load gas plant within three years, there is a strong chance it develops this field.
- **Success of cost-out:** CEN has successfully removed operating and capital costs over the past four years. It believes additional cost-out opportunities exist; delivering on these will be important for earnings.

Key risks

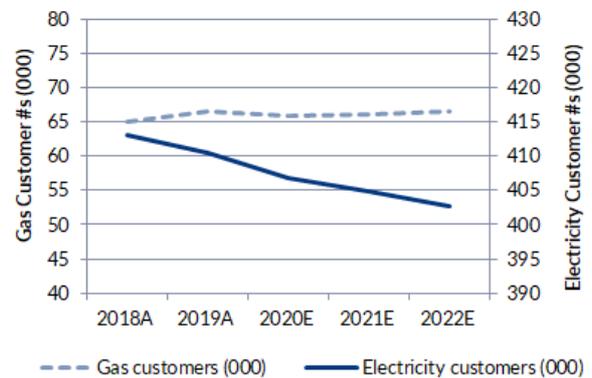
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- **Success of cost-out:** CEN has successfully removed operating and capital costs over the past four years. It believes additional cost-out opportunities exist; delivering on these will be important for earnings.

Figure 3. Generation volumes and average price received



Source: CEN, Forsyth Barr analysis

Figure 4. Customer numbers



Source: CEN, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
BlackRock Investment Management	5.4%
ACC	5.1%
The Vanguard Group	5.0%

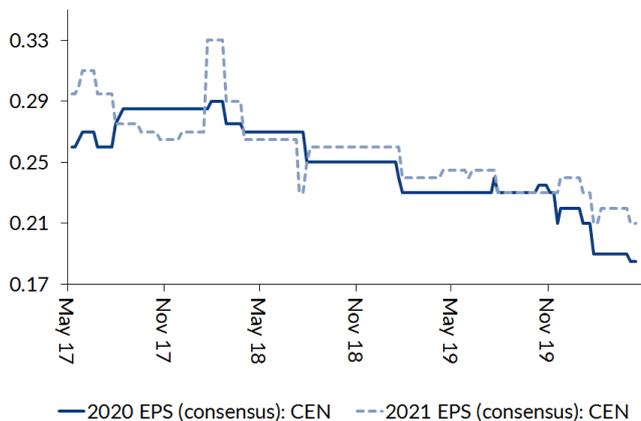
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International valuation comparisons

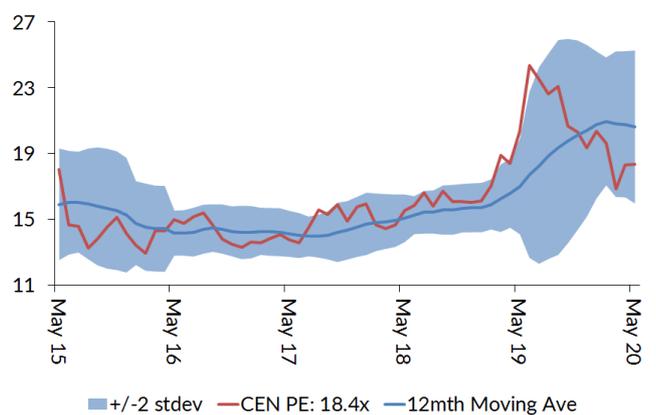
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect CEN's balance date - June)										
				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Contact Energy	CEN NZ	NZ\$6.22	NZ\$4,451	19.8x	18.3x	12.4x	11.6x	24.9x	22.5x	6.3%
Genesis Energy*	GNE NZ	NZ\$2.85	NZ\$2,957	18.0x	15.0x	11.5x	10.4x	30.1x	24.7x	6.1%
Meridian Energy*	MEL NZ	NZ\$4.82	NZ\$12,354	24.7x	27.4x	15.9x	17.1x	25.1x	27.8x	4.5%
Mercury*	MCY NZ	NZ\$4.59	NZ\$6,246	26.5x	22.9x	14.6x	14.0x	24.7x	23.2x	3.5%
Trustpower*	TPW NZ	NZ\$6.32	NZ\$1,978	22.6x	19.4x	13.2x	12.1x	16.6x	14.9x	5.4%
AGL ENERGY	AGL AT	A\$17.09	A\$10,752	13.2x	13.2x	6.5x	6.5x	10.1x	10.2x	5.7%
ORIGIN ENERGY	ORG AT	A\$4.89	A\$8,612	8.5x	17.8x	4.9x	6.5x	11.4x	20.2x	3.9%
Compcop Average:				18.9x	19.3x	11.1x	11.1x	19.7x	20.2x	4.9%
CEN Relative:				5%	-5%	12%	5%	27%	12%	29%

EV = Current Market Cap + Actual Net Debt

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

Figure 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

Genesis Energy

Mild COVID-19 Symptoms

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

OUTPERFORM

Whilst the electricity sector is facing some COVID-19 headwinds, they are relatively minor and their earnings impact on Genesis Energy (GNE) EBITDAF is largely offset by a set of strong 3Q20 operating statistics. With the impact of COVID-19 and subsequent economic downturn expected to be minor relative to other sectors, we expect the electricity sector to benefit from the lower interest rate environment. We have increased our target multiples and lowered our target dividend yield, resulting in a modest increase (+15cps to \$3.30) in our target price. We retain our OUTPERFORM rating.

Figure 1. What's changed

FY20/FY21 EBITDAF:	Lowered -\$7m/-\$1m (-2.0%/-0.1%) to \$359m/\$404m respectively
Target price:	Increased +15cps (+4.8%) to \$3.30

NZX Code	GNE	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.86	NPAT* (NZ\$m)	165.0	158.3	198.2	236.2	EV/EBITDA	11.3	11.7	10.4	9.7
Target price	NZ\$3.30	EPS* (NZc)	16.1	15.3	18.8	22.3	EV/EBIT	24.2	31.7	24.8	23.0
Risk rating	Low	EPS growth* (%)	26.3	-5.3	23.3	18.3	PE	17.7	18.7	15.2	12.8
Issued shares	1037.4m	DPS (NZc)	17.1	17.2	17.5	17.8	Price / NTA	1.6	1.7	1.8	1.9
Market cap	NZ\$2,967m	Imputation (%)	80	90	95	90	Cash div yld (%)	6.0	6.0	6.1	6.2
Avg daily turnover	543.7k (NZ\$1,698k)	*Based on normalised profits					Gross div yld (%)	7.8	8.1	8.4	8.4

Hydro impacts FY20, but strong 3Q20 operating statistics point to retail tailwinds that will help in FY21

GNE posted strong 3Q20 operating statistics, with retail sales volumes and retail margins all increasing. However, GNE lowered its FY20 EBITDAF guidance range -\$5m to between \$355m to \$365m, citing lower hydro generation volumes as the main issue. Our forecast changes are relatively minor, with FY20/FY21 EBITDAF down -2.0% and -0.1% respectively. The main factors impacting FY20 are lower hydro generation, lower oil prices offset by a low LWAP/GWAP ratio, higher than expected retail margins and retail sales volumes across all products. FY21 is also impacted by lower oil prices, and increased bad debts but benefits from the improved retail margins. More detail of sector-side changes can be found in the May 2020 edition of Power Points.

Low oil price outlook a minor headwind

Whilst the fall in oil prices is a negative for GNE, its exposure to oil prices is relatively minor. In the short-term it has oil price and currency hedging in place for ~60% of expected production over the next 12 months and ~40% for the 12 months after that. In addition, oil revenue has been declining steadily as the field declines, and forecast FY20 and FY21 oil revenue is only \$26m vs. ~\$120m for gas and LPG.

Lifting sector outlook as defensive nature of electricity is increasingly attractive

Whilst our near-term earnings outlook is slightly softer, we believe that the electricity sector is becoming increasingly attractive relative to other market opportunities. Thinking beyond COVID-19, we expect investments that offer a robust dividend will be sought after. Traditional stocks that were previously viewed as safe havens, such as property, SkyCity and airports, face greater downside issues than the electricity stocks. We have, therefore, lowered our target gross dividend yield (-0.25% to 6.25%) and lifted our target multiples modestly (adjusted PE up +2x to 24.5x), lifting our target price +15cps (+4.8%) to \$3.30.

Genesis Energy Limited (GNE)

Priced as at 06 May 2020 (NZ\$)

2.86

12-month target price (NZ\$)*						Spot valuations (NZ\$)					
Expected share price return						1. DCF				2.80	
Net dividend yield						2. Market multiple				3.37	
Estimated 12-month return						3. Dividend yield				3.72	
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					2.00%	Total firm value				4,272	
Equity beta					0.88	(Net debt)/cash				(1,308)	
WACC					6.8%	Less: Capitalised operating leases					
Terminal growth					1.5%	Value of equity				2,964	
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Sales revenue	2,304.5	3,410.0	3,229.0	3,104.4	3,130.7	EV/EBITDA (x)	11.6	11.3	11.7	10.4	9.7
Normalised EBITDA	360.5	369.5	358.7	404.3	432.5	EV/EBIT (x)	26.9	24.2	31.7	24.8	23.0
Depreciation and amortisation	(205.7)	(196.5)	(225.6)	(234.4)	(249.6)	PE (x)	22.4	17.7	18.7	15.2	12.8
Normalised EBIT	154.8	173.0	133.1	169.9	182.9	Price/NTA (x)	1.8	1.6	1.7	1.8	1.9
Net interest	(74)	(73)	(71)	(65)	(59)	Free cash flow yield (%)	5.4	5.6	6.0	7.7	8.4
Associate income	0	0	0	0	0	Net dividend yield (%)	5.9	6.0	6.0	6.1	6.2
Tax	(22)	(27)	(17)	(30)	(35)	Gross dividend yield (%)	7.7	7.8	8.1	8.4	8.4
Depreciation capex adjustment	71	92	113	122	147						
Adjusted normalised NPAT	129	165	158	198	236	Capital Structure					
Abnormals/other	(109)	(100)	(120)	(122)	(147)	Interest cover EBIT (x)	1.4	2.2	1.8	2.6	3.1
Reported NPAT	20	65	39	76	89	Interest cover EBITDA (x)	4.9	5.0	5.1	6.3	7.3
Normalised EPS (cps)	12.8	16.1	15.3	18.8	22.3	Net debt/ND+E (%)	37.7	36.8	37.6	37.1	36.4
DPS (cps)	16.9	17.1	17.2	17.5	17.8	Net debt/EBITDA (x)	3.3	3.4	3.5	2.9	2.5
Growth Rates						Key Ratios					
Revenue (%)	18.1	48.0	-5.3	-3.9	0.8	Return on assets (%)	2.4	3.5	2.8	4.0	4.5
EBITDA (%)	5.9	2.5	-2.9	12.7	7.0	Return on equity (%)	3.0	3.4	2.2	3.8	4.6
EBIT (%)	-2.0	11.8	-23.1	27.7	7.6	Return on funds employed (%)	3.6	3.7	2.9	3.9	4.4
Normalised NPAT (%)	-18.9	28.2	-4.1	25.2	19.1	EBITDA margin (%)	15.6	10.8	11.1	13.0	13.8
Normalised EPS (%)	-19.6	26.3	-5.3	23.3	18.3	EBIT margin (%)	6.7	5.1	4.1	5.5	5.8
Ordinary DPS (%)	1.8	0.9	1.0	1.6	1.7	Capex to sales (%)	4.7	2.0	2.1	2.1	1.8
						Capex to depreciation (%)	52	35	31	28	23
						Imputation (%)	80	80	90	95	90
						Pay-out ratio (%)	132	106	113	93	80
Cash Flow (NZ\$m)						Operating Performance					
EBITDA	360.5	369.5	358.7	404.3	432.5	Renewable generation	3,084	2,835	2,515	2,806	2,724
Working capital change	32.7	(27.3)	(2.4)	4.2	(4.6)	Gas generation	3,392	2,586	2,951	2,787	2,787
Interest & tax paid	(119.8)	(123.1)	(101.8)	(115.9)	(122.5)	Coal generation	657	1,410	1,211	876	876
Other	(6.9)	15.1	(7.4)	0	0	Total GNE generation (GWh)	7,133	6,831	6,677	6,469	6,388
Operating cash flow	266.5	234.2	247.1	292.7	305.4	GWAP (\$/MWh)	92	143	98	87	87
Capital expenditure	(107.7)	(68.5)	(69.3)	(64.5)	(57.0)	Retail electricity					
(Acquisitions)/divestments	0.3	(0.2)	(2.9)	0	0	Electricity customers (000)	504	499	492	488	485
Other	0	0	0	0	0	MM/SME volumes	4,169	4,077	4,140	4,056	4,034
Funding available/(required)	159.1	165.5	174.9	228.2	248.4	TOU volumes	1,811	1,992	2,037	2,058	2,078
Dividends paid	(147.7)	(131.6)	(138.6)	(142.9)	(167.1)	Total fixed price volumes (GWh)	5,980	6,068	6,177	6,113	6,113
Equity raised/(returned)	(1.1)	(1.3)	(0.1)	0	0	Average MM usage/cust (kWh/yr)	8,240	8,126	8,333	8,276	8,305
(Increase)/decrease in net debt	10.3	32.6	36.2	85.3	81.3	Average FPV price (\$/MWh)	206	210	213	209	211
						LWAP (\$/MWh)	92	139	95	87	88
						LWAP/GWAP	1.01	0.97	0.97	1.01	1.01
						Line losses (%)	5.3	5.4	5.6	5.6	5.6
						Kupe production					
						Gas production (PJ)	11.8	11.8	10.9	11.4	12.2
						Oil production (k barrels)	532.8	472.9	382.7	387.1	571.2
						LPG production (k tonnes)	45.9	50.6	47.7	50.4	54.4
Balance Sheet (NZ\$m)						Kupe EBITDAF (\$m)					
Working capital	89.8	111.8	102.5	98.3	102.9	Energy EBITDAF (\$m)	245.2	260.5	264.2	303.5	306.5
Fixed assets	3,430.0	3,773.1	3,651.7	3,501.9	3,317.3	GNE EBITDAF (\$m)	360.6	369.5	358.7	404.3	432.5
Intangibles	364.3	364.0	357.9	353.6	347.5						
Right of use asset	0	0	0	0	0						
Other assets	84.0	120.8	122.8	122.8	122.8						
Total funds employed	3,968.1	4,369.7	4,235.0	4,076.6	3,890.6						
Net debt/(cash)	1,206.1	1,293.1	1,282.4	1,212.9	1,133.6						
Lease liability	0	0	0	0	0						
Other liabilities	805.6	931.6	896.4	874.6	846.1						
Shareholder's funds	1,956.4	2,145.0	2,056.1	1,989.1	1,910.9						
Minority interests	0	0	0	0	0						
Total funding sources	3,968.1	4,369.7	4,235.0	4,076.6	3,890.6						

Forecast changes

Figure 2. Forecast changes

	FY20	FY20		FY21	FY21		FY22	FY22	
	Old	New		Old	New		Old	New	
	\$m	\$m	% Chg	\$m	\$m	% Chg	\$m	\$m	% Chg
Energy revenue	3,183	3,083	-3%	3,085	2,950	-4%	3,010	2,947	-2%
Kupe revenue	150	146	-3%	160	154	-4%	188	184	-2%
Total revenue	3,334	3,229	-3%	3,245	3,104	-4%	3,198	3,131	-2%
Energy operating costs	(2,916)	(2,819)	-3%	(2,787)	(2,647)	-5%	(2,703)	(2,640)	-2%
Kupe operating costs	(52)	(52)	0%	(53)	(53)	0%	(58)	(58)	0%
Energy EBITDAF	268	264	-1%	297	304	2%	307	307	0%
Kupe EBITDAF	98	94	-4%	107	101	-6%	130	126	-3%
Reported EBITDAF	366	359	-2%	405	404	0%	437	433	-1%
Depn & amort	(226)	(226)	0%	(234)	(234)	0%	(250)	(250)	0%
FV mvmts, assoc inc, other	(8)	(8)	0%	-	-		-	-	
EBIT	132	125	-5%	170	170	0%	188	183	-2%
Net interest	(71)	(71)	0%	(64)	(65)	1%	(59)	(59)	1%
Pre-tax profit	61	54	-11%	106	105	-1%	128	123	-4%
Tax	(17)	(15)	-11%	(30)	(30)	-1%	(36)	(35)	-4%
NPAT	44	39	-11%	76	76	-1%	92	89	-4%
Normalised NPAT	51	46	-10%	76	76	-1%	92	89	-4%
Adjusted normalised NPAT	164	158	-3%	199	198	0%	231	228	-2%
EPS (cps)	4.9	4.4	-10%	7.3	7.2	-1%	8.8	8.4	-5%
Adjusted EPS	15.8	15.3	-3%	19.0	18.8	-1%	22.0	21.4	-2%
Dividend (cps)	17.2	17.2	0%	17.5	17.5	0%	17.8	17.8	0%
Capex	95	95	0%	80	80	0%	59	66	12%
Operating statistics									
Generation (GWh)	6,655	6,677	0%	6,388	6,469	1%	6,388	6,388	0%
FPVV sales (GWh)	6,135	6,177	1%	6,135	6,113	0%	6,135	6,113	0%
Electricity customer numbers (000)	495	492	-1%	490	488	-1%	488	485	-1%
GWAP (\$/MWh)	\$114.3	\$97.9	-14%	\$108.6	\$86.5	-20%	\$96.9	\$87.0	-10%
LWAP/GWAP	0.990	0.974	-2%	1.010	1.009	0%	1.009	1.008	0%

Source: Forsyth Barr analysis

Investment Summary

Our rating is **OUTPERFORM**. GNE is trading on the sector leading dividend yield and market multiples. It also has the strongest near-term growth profile, aided by high cost gas contracts rolling off from FY21 onwards. Its downside risks to NZAS closing are also amongst the lowest in the sector.

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 NZ decarbonising transport and industrial heat.
- **Unique generation position:** Most of the value within the electricity sector lies within the generation assets. GNE has the only coal plant which is critical cover for low hydro years. Historically, monetising GNE's thermal position has been difficult, although we expect that to improve.

Earnings and cashflow outlook

- **Strategy refresh:** GNE has announced a strategy refresh which will see it embracing new technology and focussing more on the customer. GNE is targeting FY21 EBITDAF of \$400m+.
- **Gas relief coming:** GNE currently has too much gas due to legacy high priced take or pay contracts. These contracts start to roll-off after 2020, providing an earnings tailwind.

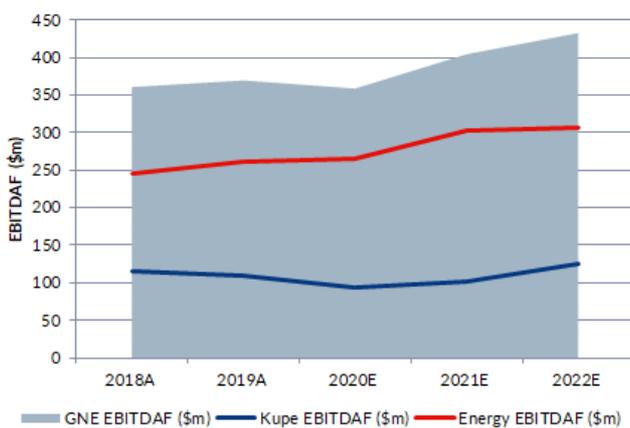
Financial structure

- **Balance sheet:** Whilst we are comfortable with debt levels, GNE's balance sheet has limited spare capacity following the acquisitions of Nova's LPG business and increasing its Kupe stake. GNE is lowering gearing through the use of a dividend reinvestment plan (DRP).

Risk factors

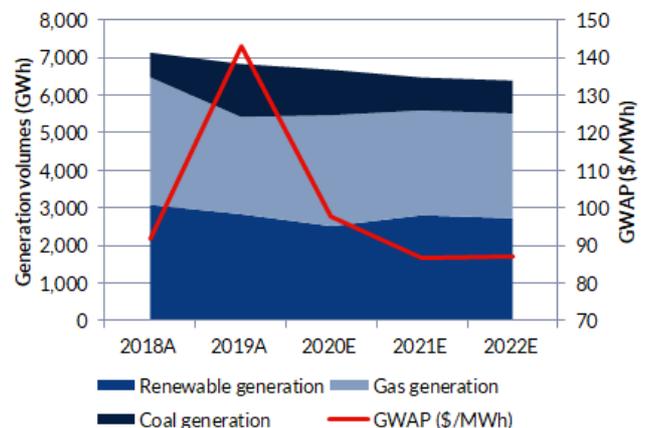
- **Increasing carbon costs:** GNE is required to relinquish an increasing value of carbon credits. Higher carbon prices combine to create financial headwinds for the next few years.
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance) and the downside risks are fully factored into GNE's share price.
- **Rising bond yields:** In recent years GNE has traded in line with bond yields. A lift in interest rates is likely to see GNE trade lower, although in our view interest rates will probably remain low for the foreseeable future.

Figure 3. EBITDAF breakdown



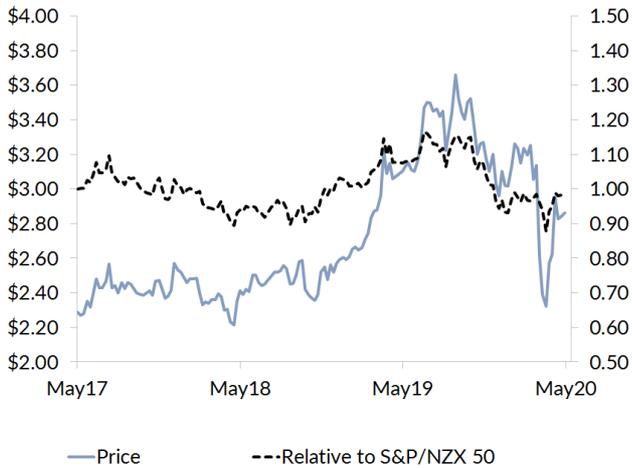
Source: GNE, Forsyth Barr analysis

Figure 4. Generation volumes and average price received



Source: GNE, Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	51.8%

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

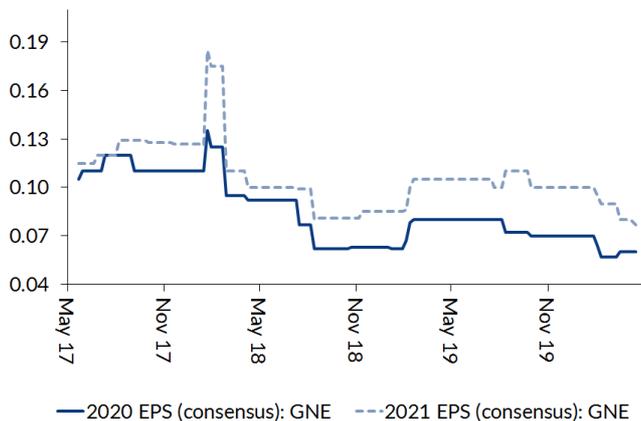
Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
(metrics re-weighted to reflect GNE's balance date - June)										
Genesis Energy	GNE NZ	NZ\$2.86	NZ\$2,967	18.7x	15.2x	11.8x	10.4x	31.7x	24.8x	6.1%
Contact Energy*	CEN NZ	NZ\$6.30	NZ\$4,524	20.1x	18.5x	12.6x	11.8x	25.2x	22.8x	6.2%
Meridian Energy*	MEL NZ	NZ\$4.82	NZ\$12,354	24.7x	27.4x	15.9x	17.1x	25.1x	27.8x	4.5%
Mercury*	MCY NZ	NZ\$4.59	NZ\$6,246	26.5x	22.9x	14.6x	14.0x	24.7x	23.2x	3.5%
Trustpower*	TPW NZ	NZ\$6.32	NZ\$1,978	22.6x	19.4x	13.2x	12.1x	16.6x	14.9x	5.4%
AGL ENERGY	AGL AT	A\$17.09	A\$10,752	13.2x	13.2x	6.5x	6.5x	10.1x	10.2x	5.7%
ORIGIN ENERGY	ORG AT	A\$4.89	A\$8,612	8.5x	17.8x	4.9x	6.5x	11.4x	20.2x	3.9%
Compcop Average:				19.3x	19.9x	11.3x	11.3x	18.9x	19.8x	4.9%
GNE Relative:				-3%	-24%	4%	-8%	68%	25%	26%

EV = Current Market Cap + Actual Net Debt

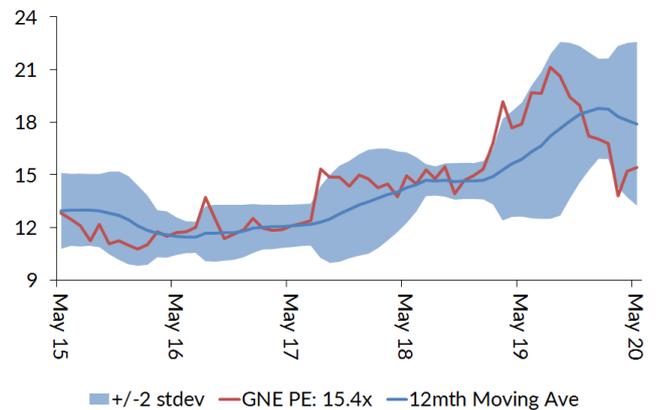
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcop metrics re-weighted to reflect headline (GNE) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

Meridian Energy

COVID-19 Limits Growth Marginally

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

OUTPERFORM

We are upgrading our Meridian Energy (MEL) rating to OUTPERFORM from NEUTRAL. We expect MEL to perform well in an investment environment that will refocus on income after the near-term COVID-19 issues subside. MEL has the strongest earnings track record in the sector, with tailwinds from recent 3Q20 performance offsetting near-term COVID-19 effects. We lift our target price +40cps (+9.1%) to \$4.80.

Figure 1. What's changed

FY20/FY21 EBITDAF:	Changed +\$6m/- \$8m (+0.7%/-1.0%) to \$870m/\$799m
Target price:	Increased +40cps (+9.1%) to \$4.80
Rating:	Upgraded to OUTPERFORM from NEUTRAL

NZX Code	MEL	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$4.48	NPAT* (NZ\$m)	481.3	505.1	444.2	453.8	EV/EBITDA	15.4	14.9	16.4	16.1
Target price	NZ\$4.80	EPS* (NZc)	18.8	19.7	17.3	17.7	EV/EBIT	23.0	23.4	26.8	25.8
Risk rating	Low	EPS growth* (%)	33.4	5.0	-12.1	2.2	PE	23.9	22.7	25.8	25.3
Issued shares	2563.0m	DPS (NZc)	21.3	21.6	21.6	21.3	Price / NTA	2.1	2.2	2.3	2.5
Market cap	NZ\$11,482m	Imputation (%)	66	65	65	70	Cash div yld (%)	4.8	4.8	4.8	4.8
Avg daily turnover	1,661k (NZ\$7,879k)	*Based on normalised profits					Gross div yld (%)	6.0	6.0	6.0	6.1

Upgrading on expected investor refocus on income

We believe that the electricity sector is becoming increasingly attractive relative to other market opportunities and MEL is the largest and lowest cost generator in the sector. Thinking beyond COVID-19, we expect investments that offer a robust dividend will be sought after. In addition, traditional stocks that were previously viewed as safe havens, such as property, SkyCity and airports, face greater downside issues than the electricity stocks. We have, therefore, lowered MEL's target gross dividend yield (-0.75% to 5.0%) and lifted our target multiples modestly (adjusted PE up +2.5x to 28.5x), which has the effect of lifting our target price +40cps (+9.1%) to \$4.80. We are upgrading to OUTPERFORM.

Strong near-term operating results provide minor FY20 earnings upgrade, COVID-19 impacts FY21 more

MEL's operating performance in 3Q20 has been strong, particularly given the headwind it faced from the HVDC constraints. It continues to grow its retail book and grow retail margins. COVID-19 has tempered that earnings growth slightly. MEL has the greatest exposure to the small medium enterprise (SME) segment which has lowered the retail sales volume growth we would have otherwise made. From FY21 we have also increased operating costs to allow for an expected increase in bad debts.

Australia also had a stronger than expected 3Q20 performance. In addition, COVID-19 restrictions has resulted in stronger residential demand, benefiting its Powershop business. However, falling wholesale electricity prices has had a negative impact on its generation business, which is most evident in FY21 and beyond outlook.

The net effect of these adjustments has seen our FY20 EBITDAF forecast increase +\$6m to \$870m, but our FY21 EBITDAF forecast reduce -\$8m to \$799m.

Meridian Energy Limited (MEL)

Priced as at 06 May 2020 (NZ\$)

4.48

12-month target price (NZ\$)*						Spot valuations (NZ\$)					
Expected share price return						1. DCF					3.69
Net dividend yield						2. Market multiple					4.97
Estimated 12-month return						3. Dividend yield					5.35
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						Total firm value					11,267
Equity beta						(Net debt)/cash					(1,817)
WACC						Less: Capitalised operating leases					
Terminal growth						Value of equity					9,451
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Sales revenue	2018A	2019A	2020E	2021E	2022E	EV/EBITDA (x)	2018A	2019A	2020E	2021E	2022E
Normalised EBITDA	3,297.0	4,104.0	3,330.4	3,397.8	3,400.6	EV/EBIT (x)	19.2	15.4	14.9	16.4	16.1
Depreciation and amortisation	666.0	838.0	870.0	798.7	812.9	PE (x)	32.1	23.0	23.4	26.8	25.8
Normalised EBIT	(21.0)	(276.0)	(314.4)	(310.7)	(306.1)	Price/NTA (x)	31.8	23.9	22.7	25.8	25.3
Net interest	398.0	562.0	555.6	488.0	506.8	Free cash flow yield (%)	2.4	2.1	2.2	2.3	2.5
Associate income & other	(81.0)	(83.0)	(83.6)	(81.5)	(80.3)	Net dividend yield (%)	1.6	4.9	3.9	4.4	4.4
Tax	(19.0)	(14.0)	(10.0)	(22.0)	(22.0)	Gross dividend yield (%)	4.3	4.8	4.8	4.8	4.8
Minority interests	(95.0)	(133.0)	(129.2)	(107.7)	(113.2)		5.4	6.0	6.0	6.0	6.1
Reported NPAT	0	0	0	0	0						
Abnormals/other	203.0	332.0	332.9	276.8	291.2	Capital Structure					
Adjusted normalised NPAT	157.8	149.3	172.3	167.4	162.6	Interest cover EBIT (x)	2018A	2019A	2020E	2021E	2022E
Normalised EPS (cps)	360.8	481.3	505.1	444.2	453.8	Interest cover EBITDA (x)	4.7	6.6	6.5	5.7	6.0
DPS (cps)	14.1	18.8	19.7	17.3	17.7	Net debt/ND+E (%)	8.2	10.1	10.4	9.8	10.1
	19.2	21.3	21.6	21.6	21.3	Net debt/EBITDA (x)	71.3	76.9	88.1	103.9	124.3
							2.2	1.7	1.8	2.1	2.1
Growth Rates						Key Ratios					
Revenue (%)	2018A	2019A	2020A	2021A	2022A	Return on assets (%)	2018A	2019A	2020E	2021E	2022E
EBITDA (%)	16.7	24.5	-18.8	2.0	0.1	Return on equity (%)	4.4	5.7	5.8	5.1	5.4
EBIT (%)	1.4	25.8	3.8	-8.2	1.8	Return on funds employed (%)	4.3	6.1	6.1	5.3	5.9
Normalised NPAT (%)	1.3	41.2	-1.1	-12.2	3.8	EBITDA margin (%)	4.6	5.9	5.8	5.3	5.7
Normalised EPS (%)	-3.1	33.4	5.0	-12.1	2.2	EBIT margin (%)	20.2	20.4	26.1	23.5	23.9
Ordinary DPS (%)	-3.1	33.4	5.0	-12.1	2.2	Capex to sales (%)	12.1	13.7	16.7	14.4	14.9
	1.5	10.9	1.5	0.0	-1.4	Capex to depreciation (%)	7.5	1.7	2.2	2.2	1.7
						Imputation (%)	n/a	28	25	27	21
						Pay-out ratio (%)	68	66	65	65	70
							136	113	110	125	120
Cash Flow (NZ\$m)						Operating Performance					
EBITDA	2018A	2019A	2020E	2021E	2022E	Hydro generation	2018A	2019A	2020E	2021E	2022E
Working capital change	666.0	838.0	870.0	798.7	812.9	Wind generation	11,266	12,326	12,564	11,946	11,701
Interest & tax paid	(34.0)	(36.0)	(68.4)	37.0	14.8	Total NZ generation (GWh)	1,263	1,244	1,471	1,430	1,430
Other	(186.0)	(200.0)	(282.0)	(232.9)	(238.6)	GWAP (\$/MWh)	83	123	79	80	77
Operating cash flow	427.0	635.0	522.6	580.8	567.1	Overseas generation (GWh)	581	730	660	712	809
Capital expenditure	(247.0)	(69.0)	(73.1)	(76.2)	(58.3)	Overseas GWAP (\$/MWh) (NZD)	151	96	122	99	82
(Acquisitions)/divestments	23.0	0	0	0	0	Overseas customer numbers (000)	97	110	137	156	167
Other	0	0	0	0	0						
Funding available/(required)	203.0	566.0	449.5	504.6	508.8	NZ electricity customers (000)	291	302	324	335	343
Dividends paid	(486.0)	(500.0)	(545.6)	(554.1)	(561.5)	Average usage per cust (MWh/yr)	13.5	13.2	13.7	13.7	13.8
Equity raised/(returned)	(2.0)	(2.0)	0	0	0	Mass market volumes	3,824	3,901	4,284	4,521	4,668
(Increase)/decrease in net debt	(285.0)	64.0	(96.1)	(49.5)	(52.7)	Time of use volumes	2,157	2,338	3,060	3,128	2,972
						Total fixed price volumes (GWh)	5,981	6,239	7,344	7,649	7,640
						NZAS sales	5,011	5,310	5,354	5,338	5,449
						Sell CFDs	2,278	2,239	2,302	2,002	2,002
						Buy CFDs	(2,222)	(1,965)	(2,399)	(1,947)	(1,947)
						Total Sales (GWh)	11,047	11,823	12,601	13,043	13,144
						Average FPV price (\$/MWh)	105	105	109	111	110
Balance Sheet (NZ\$m)											
Working capital	2018A	2019A	2020E	2021E	2022E	LWAP (\$/MWh)	88	132	83	85	81
Fixed assets	(17.0)	(24.0)	10.4	(4.6)	2.6	LWAP/GWAP	1.06	1.07	1.05	1.06	1.05
Intangibles	7,941.0	8,825.0	8,659.2	8,425.6	8,176.1	Lines losses (%)	5.3	5.9	4.9	5.5	5.5
Right of use asset	60.0	59.0	56.5	55.7	57.3						
Other assets	0	0	0	0	0						
Total funds employed	291.0	383.0	403.0	381.0	359.0						
Net debt/(cash)	8,275.0	9,243.0	9,129.2	8,857.6	8,594.9						
Lease liability	1,461.0	1,424.0	1,599.1	1,648.6	1,701.3						
Other liabilities	0	0	0	0	0						
Shareholder's funds	1,991.0	2,362.0	2,284.8	2,241.0	2,195.9						
Minority interests	4,823.0	5,457.0	5,245.3	4,968.0	4,697.6						
Total funding sources	0	0	0	0	0						
	8,275.0	9,243.0	9,129.2	8,857.6	8,594.9						

Forecast changes

Figure 2. Forecast changes

	FY20	FY20		FY21	FY21		FY22	FY22	
	Old	New	Chg	Old	New	Chg	Old	New	Chg
	\$m	\$m	%	\$m	\$m	%	\$m	\$m	%
NZ Energy Margin	1,139	1,140	0.1%	1,052	1,065	1.2%	1,041	1,059	1.7%
Australia Energy Margin	111	116	4.7%	110	102	-7.1%	113	106	-6.0%
Energy margin	1,250	1,256	0.5%	1,162	1,167	0.4%	1,154	1,165	0.9%
Other revenue	26	26	0.0%	29	29	0.0%	29	29	0.0%
Transmission costs	(123)	(123)	0.0%	(88)	(88)	0.0%	(84)	(84)	0.0%
Operating costs	(290)	(290)	0.1%	(296)	(309)	4.4%	(291)	(297)	2.1%
EBITDAF	864	870	0.7%	807	799	-1.0%	808	813	0.6%
Depn & amort	(314)	(314)	0.0%	(311)	(311)	0.0%	(306)	(306)	0.0%
EBIT	550	556	1.1%	496	488	-1.7%	502	507	0.9%
Net interest	(84)	(84)	-0.1%	(81)	(82)	0.9%	(80)	(80)	0.4%
FV mvmts, assoc inc, other	(10)	(10)	0.0%	(22)	(22)	0.0%	(22)	(22)	0.0%
Pre-tax profit	456	462	1.3%	394	384	-2.3%	400	404	1.0%
Tax	(128)	(129)	1.3%	(110)	(108)	-2.3%	(112)	(113)	1.0%
NPAT	329	333	1.3%	283	277	-2.3%	288	291	1.0%
Normalised NPAT	314	318	1.4%	268	261	-2.4%	272	275	1.1%
FB adjusted NPAT	501	505	0.9%	451	444	-1.4%	451	454	0.7%
Dividend (cps)	21.5	21.6	0.6%	21.5	21.6	0.6%	21.2	21.3	0.5%
Normalised EPS	12.3	12.4	1.4%	10.4	10.2	-2.4%	10.6	10.7	1.1%
Operating statistics									
NZ generation (GWh)	14,117	14,035	-0.6%	13,419	13,376	-0.3%	13,175	13,131	-0.3%
FPVV sales (GWh)	7,242	7,344	1.4%	7,342	7,649	4.2%	7,316	7,640	4.4%
Customer numbers (000)	320	324	1.2%	331	335	1.2%	338	343	1.2%
GWAP (\$/MWh)	\$90.1	\$78.6	-12.8%	\$96.3	\$80.1	-16.8%	\$86.9	\$76.6	-11.8%

Source: Forsyth Barr analysis

Investment Summary

Our rating is **OUTPERFORM**. MEL has been the strongest electricity performer in recent years and its low cost generation assets provides it with a strong defensive position. Its dividend yield is attractive, although we do not expect any near-term growth as it includes a significant special dividend component.

Business quality

- **Low risk, modest growth industry:** Electricity demand is inelastic and the industry is well positioned to benefit from NZ electrifying transport and industrial processes.
- **Strong generation position:** Most of the value within the electricity sector lies within the generation assets. MEL is the largest generator in New Zealand, producing ~32% of New Zealand’s electricity and controls ~50% of New Zealand’s hydro storage. It is also the lowest cost generator.
- **Track record:** Since listing in 2014, MEL has demonstrated an ability to unlock value and has lifted underlying operating earnings ~+33%.

Earnings and cashflow outlook

- **Earnings fall after FY20:** We expect earnings to fall in FY21 after two remarkable years of well above average hydro generation and high wholesale electricity prices. We expect transmission benefits to be offset by a gradually declining wholesale electricity price.
- **Cash flow strong in near-term:** Limited electricity demand growth means capital expenditure is limited, resulting in strong free cash flows.

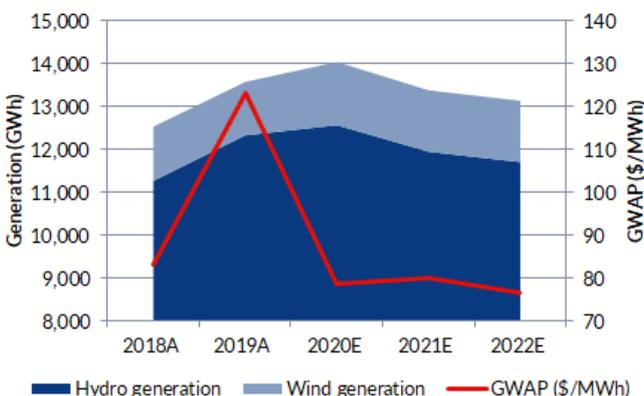
Financial structure

- **Balance sheet:** Management recognises that surplus cash is better with shareholders. MEL currently has spare capacity on its balance sheet and has in place a capital management plan that is gradually lifting gearing.
- **Dividends:** MEL’s strong free cash flow enables it to pay high dividends, which are currently elevated due to the capital management plan.

Risk factors

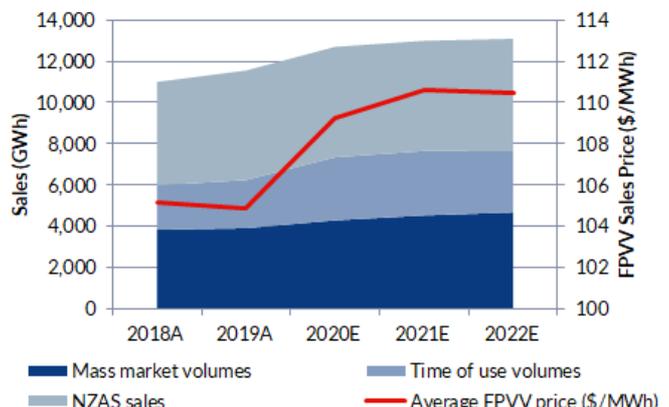
- **Political/regulatory:** The 2014 election and recent Electricity Price Review (EPR) highlighted the political/regulatory risks inherent in the sector. Whilst the EPR gave the sector a thumbs up in most areas, the political risk is unlikely to ever disappear.
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance).

Figure 3. Generation and average price received

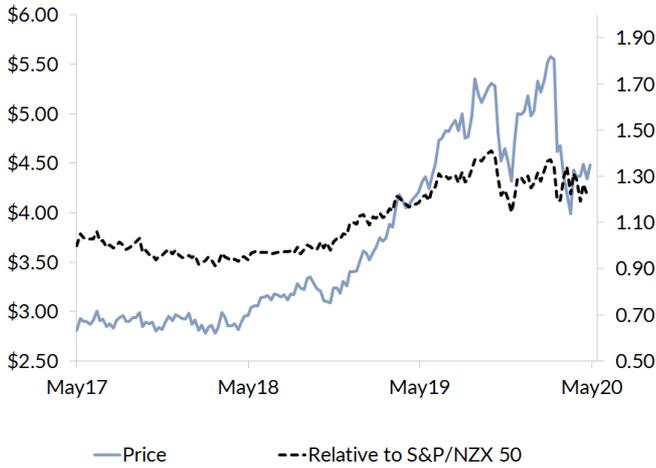


Source: MEL, Forsyth Barr analysis

Figure 4. Retail sales volumes and average retail price



Source: MEL, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

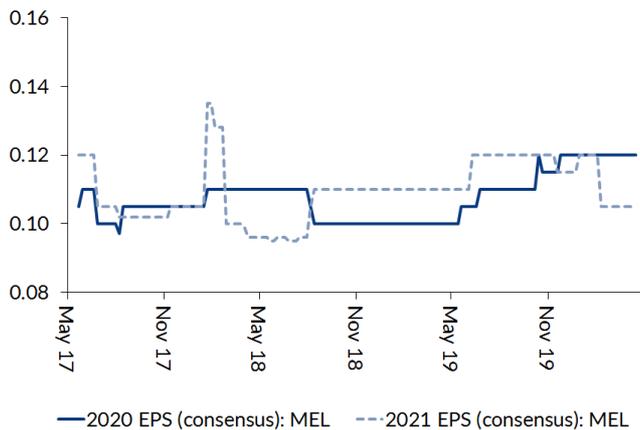
Shareholder	Latest Holding
NZ Govt	51.0%

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

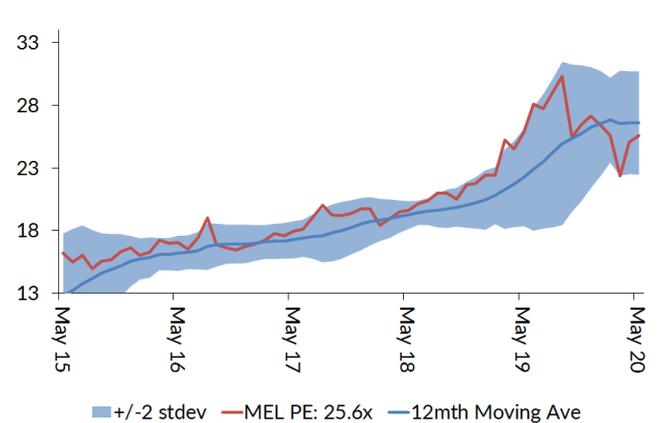
Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld		
(metrics re-weighted to reflect MEL's balance date - June)												
				2020E	2021E	2020E	2021E	2020E	2021E	2021E		
Meridian Energy	MEL NZ	NZ\$4.48	NZ\$11,482	22.7x	25.8x	14.8x	16.2x	23.2x	26.4x	4.8%		
Contact Energy*	CEN NZ	NZ\$6.30	NZ\$4,524	20.1x	18.5x	12.6x	11.8x	25.2x	22.8x	6.2%		
Genesis Energy*	GNE NZ	NZ\$2.85	NZ\$2,957	18.7x	15.1x	11.7x	10.4x	31.6x	24.8x	6.1%		
Mercury*	MCY NZ	NZ\$4.59	NZ\$6,246	27.2x	23.7x	14.9x	14.3x	25.5x	24.1x	3.5%		
Trustpower*	TPW NZ	NZ\$6.32	NZ\$1,978	22.6x	19.4x	13.2x	12.1x	16.6x	14.9x	5.4%		
AGL ENERGY	AGL AT	A\$17.09	A\$10,752	13.2x	13.2x	6.5x	6.5x	10.1x	10.2x	5.7%		
INFIGEN ENERGY	IFN AT	A\$0.53	A\$514	13.9x	16.1x	6.2x	6.7x	10.2x	11.8x	3.8%		
ORIGIN ENERGY	ORG AT	A\$4.89	A\$8,612	8.5x	17.8x	4.9x	6.5x	11.4x	20.2x	3.9%		
Compcop Average:				17.7x	17.7x	10.0x	9.7x	18.7x	18.4x	4.9%		
EV = Current Market Cap + Actual Net Debt				MEL Relative:		28%	46%	48%	66%	24%	44%	-2%

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

Figure 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

Mercury

Rare Dividend Growth Coming

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

OUTPERFORM

We are upgrading our Mercury (MCY) rating to OUTPERFORM from NEUTRAL. We expect MCY to perform well in an investment environment that will refocus on income after the near-term COVID-19 issues subside. MCY has the strongest dividend growth profile in the sector, courtesy of its under construction wind farm and a benign balance sheet. The expected investment sentiment in favour of defensive yield stocks outweighs the drop in short-term earnings. We lift our target price +7.6% to \$4.95.

Figure 1. What's changed

FY20/FY21 EBITDAF:	Lowered -\$8m/-\$12m (-1.7%/-2.2%) to \$493m/\$514m respectively
Target price:	Increased +35cps (+7.6%) to \$4.95
Rating:	Upgraded to OUTPERFORM from NEUTRAL

Source: Forsyth Barr analysis

NZX Code	MCY	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$4.50	NPAT* (NZ\$m)	239.0	229.5	263.8	278.0	EV/EBITDA	13.9	14.1	13.7	13.0
Target price	NZ\$4.95	EPS* (NZc)	17.6	16.9	19.4	20.4	EV/EBIT	23.3	24.2	23.1	21.3
Risk rating	Low	EPS growth* (%)	-6.4	-4.0	14.9	5.4	PE	25.6	26.7	23.2	22.0
Issued shares	1360.9m	DPS (NZc)	15.5	15.8	16.2	18.1	Price / NTA	1.8	1.8	1.8	1.8
Market cap	NZ\$6,117m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.4	3.5	3.6	4.0
Avg daily turnover	1,053k (NZ\$5,032k)	*Based on normalised profits					Gross div yld (%)	4.8	4.9	5.0	5.6

Upgrading to OUTPERFORM on attractive yield profile with growth potential

Whilst our near-term earnings outlook is slightly softer, we believe that the electricity sector is becoming increasingly attractive relative to other market opportunities. Thinking beyond COVID-19, we expect investments that offer a robust dividend will be sought after. Whilst MCY has the lowest headline dividend gross yield in the electricity sector, it has the highest expected three year dividend growth of +~30% following the construction of its Turitea wind farm. In addition, traditional stocks that were previously viewed as safe havens, such as property, SkyCity and airports, face greater downside issues than the electricity stocks. We have, therefore, lowered our target gross dividend yield (-0.75% to 4.25%) and lifted our target multiples modestly (adjusted PE up +3.5x to 27.5x), which has the effect of offsetting our modest earnings cuts and lifting our target price +35cps (+7.6%) to \$4.95. We are upgrading to OUTPERFORM.

Near-term earnings impact due to lack of water

We have lowered our FY20 EBITDAF forecast -\$8m (-1.7%) to \$493m with the main driver being expected lower hydro generation volumes. This is consistent with MCY's revised EBITDAF guidance of \$490m, down -\$10m, also due to it lowering its hydro generation guidance -100GWh to 3,800GWh. MCY's 3Q20 operating statistics were generally solid, with the expected lift in commercial pricing coming through, better than expected, at +19.9%. Looking out to FY21, the main drivers of the lower earnings forecast (EBITDAF down -2.2% to \$514m) are a lift in bad debts and the lower wholesale electricity price outlook.

Mercury NZ Limited (MCY)

Priced as at 06 May 2020 (NZ\$)

4.50
12-month target price (NZ\$)*
4.95

Expected share price return

10.0%

Net dividend yield

3.6%

Estimated 12-month return

13.6%

Spot valuations (NZ\$)

1. DCF

3.85

2. Market multiple

5.54

3. Dividend yield

5.41

Key WACC assumptions

Risk free rate

2.00%

Equity beta

0.88

WACC

6.8%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

6,542

(Net debt)/cash

(1,211)

Less: Capitalised operating leases

Value of equity

5,330

Profit and Loss Account (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Sales revenue	1,798.0	2,000.0	1,678.5	1,660.3	1,683.0
Normalised EBITDA	566.0	505.0	492.7	514.3	542.2
Depreciation and amortisation	(201.0)	(204.0)	(207.5)	(209.0)	(212.3)
Normalised EBIT	365.0	301.0	285.3	305.3	329.9
Net interest	(91.0)	(75.0)	(57.6)	(60.4)	(64.8)
Associate income	2.0	1.0	3.0	0	0
Tax	(91.0)	(73.0)	(49.1)	(70.6)	(76.2)
Depreciation capex adj	57.6	77.8	63.0	89.5	89.1
Adjusted normalised NPAT	255.6	239.0	229.5	263.8	278.0
Abnormals/other	(6.6)	118.0	(70.0)	(89.5)	(89.1)
Reported NPAT	249.0	357.0	159.5	174.3	188.8
Normalised EPS (cps)	18.8	17.6	16.9	19.4	20.4
DPS (cps)	15.1	15.5	15.8	16.2	18.1

Growth Rates

	2018A	2019A	2020A	2021A	2022A
Revenue (%)	12.6	11.2	-16.1	-1.1	1.4
EBITDA (%)	8.2	-10.8	-2.4	4.4	5.4
EBIT (%)	7.9	-17.7	-4.5	5.9	8.1
Normalised NPAT (%)	1.8	-6.5	-4.0	14.9	5.4
Normalised EPS (%)	2.9	-6.4	-4.0	14.9	5.4
Ordinary DPS (%)	3.4	2.6	1.9	2.5	11.7

Cash Flow (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
EBITDA	566.0	505.0	492.7	514.3	542.2
Working capital change	4.0	2.0	48.9	(32.4)	(18.4)
Interest & tax paid	(192.0)	(148.0)	(149.5)	(150.9)	(161.2)
Other	(4.0)	(33.0)	(8.0)	0	0
Operating cash flow	374.0	326.0	384.1	331.0	362.6
Capital expenditure	(127.0)	(122.0)	(308.0)	(254.9)	(161.4)
(Acquisitions)/divestments	(139.0)	215.0	0	0	0
Other	1.0	12.0	0.8	(2.5)	(2.7)
Funding available/(required)	109.0	431.0	77.0	73.6	198.5
Dividends paid	(273.0)	(208.0)	(214.1)	(216.4)	(224.5)
Equity raised/(returned)	(50.0)	0	0	0	0
(Increase)/decrease in net debt	(214.0)	223.0	(137.1)	(142.7)	(26.1)

Balance Sheet (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Working capital	63.0	63.0	19.1	51.5	69.9
Fixed assets	5,370.0	5,528.0	5,636.7	5,686.2	5,639.0
Intangibles	85.0	62.0	60.1	60.6	61.4
Right of use asset	0	0	0	0	0
Other assets	385.0	521.0	516.2	518.6	521.4
Total funds employed	5,903.0	6,174.0	6,232.0	6,317.0	6,291.7
Net debt/(cash)	1,264.0	1,096.0	1,229.1	1,371.8	1,397.9
Lease liability	0	0	0	0	0
Other liabilities	1,306.0	1,498.0	1,482.5	1,466.8	1,451.2
Shareholder's funds	3,333.0	3,580.0	3,520.4	3,478.3	3,442.6
Minority interests	0	0	0	0	0
Total funding sources	5,903.0	6,174.0	6,232.0	6,317.0	6,291.7

Valuation Ratios

	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	12.6	13.9	14.2	13.7	13.0
EV/EBIT (x)	19.4	23.3	24.2	23.1	21.4
PE (x)	24.0	25.6	26.7	23.2	22.0
Price/NTA (x)	1.9	1.8	1.8	1.8	1.8
Free cash flow yield (%)	4.0	3.3	1.2	1.2	3.3
Net dividend yield (%)	3.4	3.4	3.5	3.6	4.0
Gross dividend yield (%)	4.7	4.8	4.9	5.0	5.6

Capital Structure

	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	4.7	6.7	4.6	5.1	5.1
Interest cover EBITDA (x)	6.2	6.7	8.5	8.5	8.4
Net debt/ND+E (%)	70.8	61.8	66.3	70.2	71.9
Net debt/EBITDA (x)	2.2	2.2	2.5	2.7	2.6

Key Ratios

	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	7.1	7.8	4.1	4.6	5.0
Return on equity (%)	6.0	4.6	4.8	5.1	5.6
Return on funds employed (%)	5.8	4.7	4.4	4.6	5.0
EBITDA margin (%)	31.5	25.3	29.4	31.0	32.2
EBIT margin (%)	20.4	15.1	17.2	18.4	19.6
Capex to sales (%)	7.1	6.1	18.3	15.3	9.6
Capex to depreciation (%)	69	67	168	136	85
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	80	88	94	84	89

Operating Performance

	2018A	2019A	2020E	2021E	2022E
Hydro	4,947	4,006	3,823	4,016	4,016
Geothermal	2,757	2,894	2,815	2,841	2,841
Wind	0	0	0	181	562
Total MCY Generation (GWh)	7,704	6,900	6,637	7,038	7,419
GWAP (\$/MWh)	86	139	97	86	86

Electricity sales

	2018A	2019A	2020E	2021E	2022E
Electricity customers (000)	388	373	350	346	343
MM volumes	3,278	3,182	2,801	2,823	2,801
TOU volumes	1,200	1,319	1,478	1,537	1,544
Total Fixed Price volumes (GWh)	4,478	4,501	4,279	4,360	4,345
Spot Sales	891	780	729	732	736
Net CFD's	2,110	1,665	1,881	2,069	2,069
Total Sales (GWh)	7,479	6,946	6,888	7,161	7,150
Average usage per cust (MWh/yr)	11.4	11.8	11.9	12.5	12.6
LWAP (\$/MWh)	92	145	100	91	91
LWAP/GWAP	1.06	1.04	1.03	1.05	1.06
Average FPV price (\$/MWh)	113	113	117	120	121
Line losses (%)	5.6	5.1	5.1	5.2	5.1

Energy margin (\$m)

	2018A	2019A	2020E	2021E	2022E
Energy margin (\$m)	730	667	668	695	726
Operating costs (\$m)	(205)	(199)	(192)	(200)	(205)
Other revenue (\$m)	41	37	17	20	21
MCY EBITDAF (\$m)	566	505	493	514	542

Forecast changes

Figure 2. Forecast changes

	FY20	FY20		FY21	FY21		FY22	FY22	
	Old	New		Old	New		Old	New	
	\$m	\$m	% Chg	\$m	\$m	% Chg	\$m	\$m	% Chg
Sales revenue	1,762	1,659	-6%	1,750	1,638	-6%	1,709	1,660	-3%
Cost of sales	(1,086)	(992)	-9%	(1,050)	(943)	-10%	(973)	(934)	-4%
Energy margin	676	668	-1%	700	695	-1%	736	726	-1%
Other income	17	17	0%	20	20	0%	21	21	0%
Other operating costs	(192)	(192)	0%	(194)	(200)	3%	(203)	(205)	1%
EBITDAF	501	493	-1.7%	526	514	-2.2%	554	542	-2.1%
Depn & amort	(207)	(207)	0%	(209)	(209)	0%	(212)	(212)	0%
FV mvmts, assoc inc, other	(19)	(19)	0%	-	-		4	3	-7%
EBIT	275	266	-3%	317	305	-4%	345	333	-3%
Net interest	(58)	(58)	0%	(60)	(60)	1%	(64)	(65)	1%
Pre-tax profit	217	209	-4%	257	245	-5%	281	269	-4%
Tax	(52)	(49)	-5%	(74)	(71)	-4%	(80)	(76)	-4%
NPAT	166	159	-4%	183	174	-5%	201	192	-4%
Normalised NPAT	173	167	-4%	183	174	-5%	198	189	-4%
Dividend (cps) (incl specials)	15.8	15.8	0%	16.2	16.2	0%	18.6	18.1	-3%
Operating statistics									
Generation (GWh)	6,697	6,637	-0.9%	7,040	7,038	0.0%	7,421	7,419	0.0%
FPVV sales (GWh)	4,370	4,279	-2.1%	4,363	4,360	-0.1%	4,347	4,345	-0.1%
Customer numbers (000)	352.4	349.9	-0.7%	348.9	346.5	-0.7%	345.4	343.0	-0.7%
GWAP (\$/MWh)	\$110.0	\$97.1	-11.7%	\$105.2	\$86.1	-18.2%	\$93.3	\$86.5	-7.3%
LWAP/GWAP	1.042	1.032	-0.9%	1.050	1.052	0.2%	1.056	1.056	0.0%

Source: Forsyth Barr analysis

Investment Summary

Our rating is OUTPERFORM. MCY is a strong operator in the sector with well-positioned generation assets. Whilst its near-term dividend yield is the lowest in the sector, we expect that to improve following the completion of its Turitea wind farm in 2021. It has the strongest dividend growth profile in the sector.

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.
- **Strong generation position:** The value within the electricity sector lies within the generation assets. MCY is the largest North Island generator and its hydro generation is suited to meeting electricity demand peaks.
- **Track record:** MCY has a strong development track record, having built a geothermal generation portfolio in the past 15 years and is expanding into wind.

Earnings and cashflow outlook

- **Earnings growth after FY21:** MCY's move into a development phase will drive earnings growth after FY21. The new wind farm development at Turitea is likely to add ~\$55m (~+11%) per annum to underlying EBITDAF.
- **Operating cash flow strong but development restarting:** MCY has a strong track record of returning surplus cash to shareholders; however, with new generation under development, capital returns above the ordinary dividend are less likely.

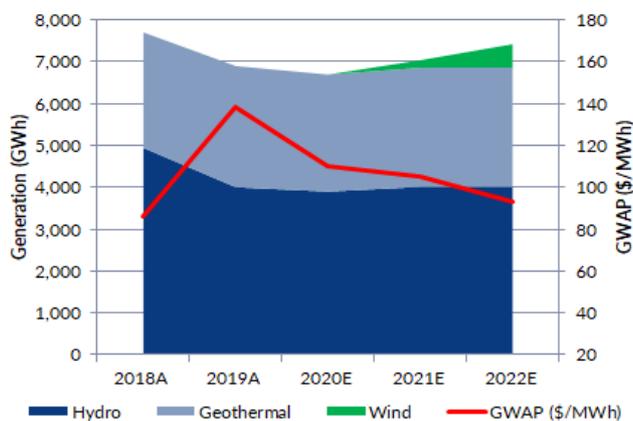
Financial structure

- **Balance sheet:** MCY's balance sheet has reasonable headroom (particularly after including treasury shares acquired in past buy-backs). Its Tilt Renewables investment and decision to build new generation means there is no surplus capital for the next few years.

Risk factors

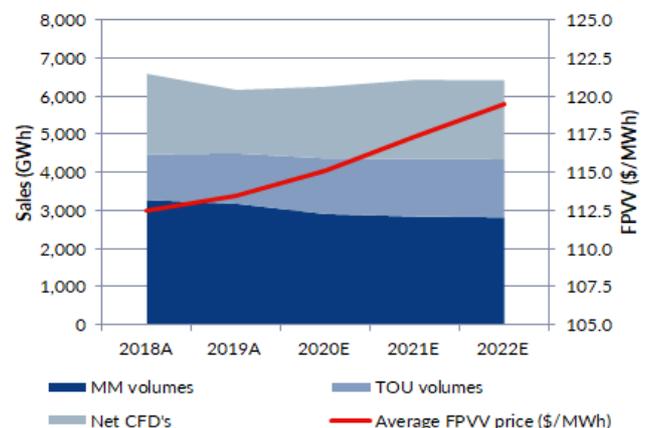
- **Political/regulatory:** The 2014 election and recent Electricity Price Review (EPR) highlighted the political/regulatory risks inherent in the sector. Whilst the EPR gave the sector a thumbs-up in most areas, the political risk is unlikely to ever disappear.
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance), but if it did MCY would be one of the least affected generator/retailers.

Figure 3. Generation volumes and average price received



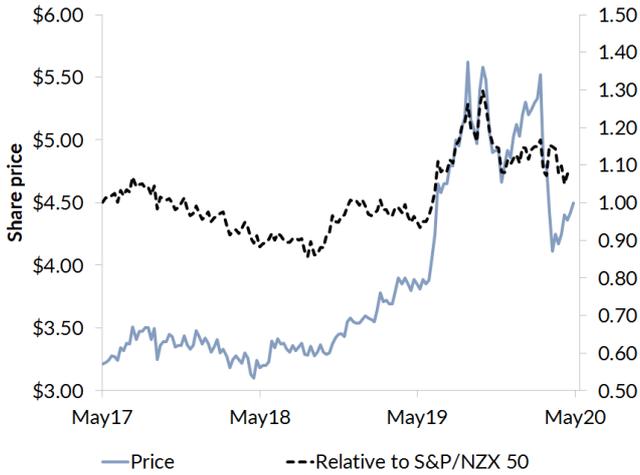
Source: MCY, Forsyth Barr analysis

Figure 4. Sales volumes and average price received



Source: MCY, Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	52.6%

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

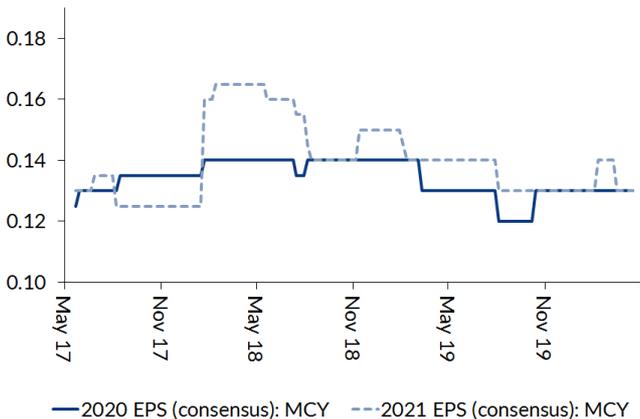
Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect MCY's balance date - June)										
				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Mercury	MCY NZ	NZ\$4.50	NZ\$6,117	26.7x	23.2x	14.6x	14.0x	25.0x	23.6x	3.6%
Contact Energy*	CEN NZ	NZ\$6.30	NZ\$4,524	20.1x	18.5x	12.6x	11.8x	25.2x	22.8x	6.2%
Genesis Energy*	GNE NZ	NZ\$2.85	NZ\$2,957	18.7x	15.1x	11.7x	10.4x	31.6x	24.8x	6.1%
Meridian Energy*	MEL NZ	NZ\$4.82	NZ\$12,354	24.7x	27.4x	15.9x	17.1x	25.1x	27.8x	4.5%
Trustpower*	TPW NZ	NZ\$6.32	NZ\$1,978	22.6x	19.4x	13.2x	12.1x	16.6x	14.9x	5.4%
AGL ENERGY	AGL AT	A\$17.09	A\$10,752	13.2x	13.2x	6.5x	6.5x	10.1x	10.2x	5.7%
ORIGIN ENERGY	ORG AT	A\$4.89	A\$8,612	8.5x	17.8x	4.9x	6.5x	11.4x	20.2x	3.9%
Compcp Average:				18.0x	18.6x	10.8x	10.7x	20.0x	20.1x	5.3%
MCY Relative:				48%	25%	35%	31%	25%	18%	-32%

EV = Current Market Cap + Actual Net Debt

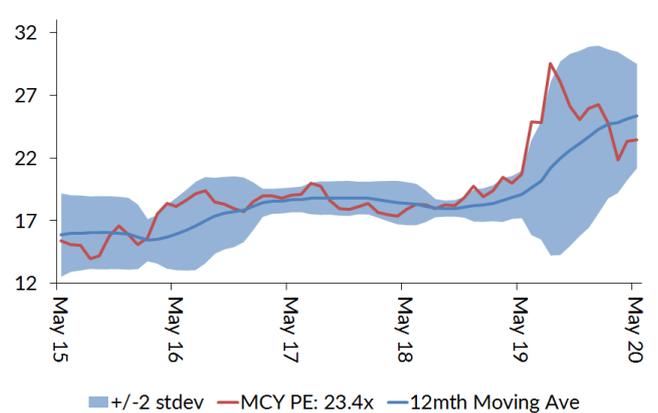
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcp metrics re-weighted to reflect headline (MCY) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

Trustpower

Mild COVID-19 Symptoms

ANDREW HARVEY-GREEN

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

SCOTT ANDERSON

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

OUTPERFORM

Like all the electricity companies, we do not expect a material impact on Trustpower's (TPW) earnings from COVID-19. Whilst electricity demand is likely to be a little lower, that appears to be getting close to normal, with an increase in bad debts a bigger concern. We have trimmed our FY21 EBITDAF forecast -2.2%, but with investors expected to focus on defensive income in the coming months we are retaining our OUTPERFORM rating.

Figure 1. What's changed

FY20/FY21 EBITDAF: FY20 EBITDAF unchanged at \$187m, FY21 EBITDAF -\$4m (-2.2%) to \$203m
Target price: Increased +5cps (+0.6%) to \$7.75

NZX Code	TPW	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$6.61	NPAT* (NZ\$m)	116.6	84.0	97.2	103.5	EV/EBITDA	11.7	14.4	13.5	12.9
Target price	NZ\$7.75	EPS* (NZc)	37.1	26.8	31.0	32.9	EV/EBIT	14.8	18.3	16.8	15.9
Risk rating	Low	EPS growth* (%)	-17.3	-27.9	15.7	6.4	PE	17.8	24.7	21.3	20.1
Issued shares	313.0m	DPS (NZc)	74.0	34.0	34.0	34.0	Price / NTA	1.7	1.9	1.9	1.9
Market cap	NZ\$2,069m	Imputation (%)	55	100	100	100	Cash div yld (%)	11.2	5.1	5.1	5.1
Avg daily turnover	57.1k (NZ\$414k)	*Based on normalised profits					Gross div yld (%)	13.6	7.1	7.1	7.1

FY20 result will be below average after two strong years

We are forecasting an FY20 EBITDAF of \$187m, in the lower half of TPW's \$185m to \$195m guidance range, -16% lower than the pcp. FY20 has had its challenges, with lower hydro volumes a key factor. The competitive retail market has also had an impact on earnings, although we expect the telco segment to again be a positive highlight. Whilst we are not forecasting TPW to trim its dividend (typically electricity companies look through soft short-term earnings periods), the below average FY20 result coupled with COVID-19 uncertainties and a slightly stretched balance sheet may see TPW take a more conservative approach. TPW's FY20 result will be reported on Wednesday 27 May.

FY21 outlook tempered on modest COVID-19 effects

We have trimmed our FY21 EBITDAF forecast -\$4m to \$203m due to lower electricity sales volumes (down -2.3%), a modest increase in bad debts and the lower wholesale electricity price outlook (down -8.6%).

Expected investor focus on yield to provide share price support for TPW

Whilst our near-term earnings outlook is softer, we believe that the electricity sector is becoming increasingly attractive relative to other market opportunities. Thinking beyond COVID-19, we expect investments that offer a robust dividend will be sought after. Traditional stocks that were previously viewed as safe havens, such as property, SkyCity and airports, face greater downside issues than the electricity stocks. We have, therefore, lowered our target gross dividend yield (-0.15% to 5.75%) and lifted our target multiples modestly (adjusted PE up 0.5x to 24x), which has the effect of offsetting our modest earnings cuts.

Trustpower Ltd (TPW)

Priced as at 06 May 2020 (NZ\$)

6.61

12-month target price (NZ\$)*						Spot valuations (NZ\$)					
Expected share price return						1. DCF					7.21
Net dividend yield						2. Market multiples					7.39
Estimated 12-month return						3. Dividend Yield					8.14
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					2.00%	Total firm value					2,982
Equity beta					0.88	(Net debt)/cash					(687)
WACC					6.7%	Less: Capitalised operating leases					
Terminal growth					1.5%	Value of equity					2,279
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Sales revenue	2018A	2019A	2020E	2021E	2022E	EV/EBITDA (x)	2018A	2019A	2020E	2021E	2022E
Normalised EBITDA	979.4	1,030.1	975.7	937.3	973.3	EV/EBIT (x)	9.8	11.7	14.4	13.5	12.9
Depreciation and amortisation	269.8	222.2	186.9	202.8	212.7	PE (x)	11.9	14.8	18.3	16.8	15.9
Normalised EBIT	(15.8)	(47.2)	(39.5)	(39.8)	(40.3)	Price/NTA (x)	14.7	17.8	24.7	21.3	20.1
Net interest	223	175	147	163	172	Free cash flow yield (%)	1.5	1.7	1.9	1.9	1.9
Depreciation capex adjustment	(34)	(28)	(35)	(36)	(37)	Net dividend yield (%)	8.0	4.3	2.7	5.0	5.7
Tax	8	19	9	11	11	Gross dividend yield (%)	5.1	11.2	5.1	5.1	5.1
Minority interests	(55)	(48)	(35)	(40)	(42)		7.1	13.6	7.1	7.1	7.1
Normalised NPAT	(1)	(2)	(2)	(2)	(2)						
Abnormals/other/depn adj	141	117	84	97	103	Capital Structure					
Reported NPAT	141	117	84	97	103	Interest cover EBIT (x)	2018A	2019A	2020E	2021E	2022E
Normalised EPS (cps)	(13)	(26)	(17)	(8)	(8)	Interest cover EBITDA (x)	7.0	6.8	4.5	4.8	5.0
DPS (cps)	128	91	67	89	95	Net debt/ND+E (%)	7.9	7.9	5.4	5.6	5.8
	44.9	37.1	26.8	31.0	32.9	Net debt/EBITDA (x)	48.9	58.6	68.2	69.5	70.0
	34.0	74.0	34.0	34.0	34.0		1.7	2.5	3.5	3.3	3.1
Growth Rates						Key Ratios					
Revenue (%)	2018A	2019A	2020A	2021A	2022A	Return on assets (%)	2018A	2019A	2020E	2021E	2022E
EBITDA (%)	4.2	5.2	-5.3	-3.9	3.8	Return on equity (%)	9.2	7.2	5.9	7.3	7.8
EBIT (%)	15.0	-17.6	-15.9	8.5	4.9	Return on funds employed (%)	9.9	9.7	7.6	8.9	9.6
Normalised NPAT (%)	19.3	-21.6	-15.7	10.5	5.8	EBITDA margin (%)	8.5	7.2	5.9	6.4	6.8
Normalised EPS (%)	8.5	-17.3	-27.9	15.7	6.4	EBIT margin (%)	27.5	21.6	19.2	21.6	21.9
Ordinary DPS (%)	8.5	-17.3	-27.9	15.7	6.4	Capex to sales (%)	22.8	17.0	15.1	17.4	17.7
	3.0	0.0	0.0	0.0	0.0	Capex to depreciation (%)	4.2	3.0	3.1	3.0	3.0
						Imputation (%)	n/a	98	104	97	99
						Pay-out ratio (%)	100	55	100	100	100
							76	199	127	110	103
Cash Flow (NZ\$m)						Operating Performance					
EBITDA	2018A	2019A	2020E	2021E	2022E	NZ electricity revenue	2018A	2019A	2020E	2021E	2022E
Working capital change	269.8	222.2	186.9	202.8	212.7	Gas revenue	810	861	803	765	793
Interest & tax paid	24.6	(47.1)	(42.6)	0.7	9.1	Telecommunication revenue	29	29	30	33	34
Other	(63.8)	(74.8)	(79.0)	(71.5)	(75.6)	Other revenue	81	88	92	95	103
Operating cash flow	207.7	120.3	85.7	132.0	146.3	Total revenue	60	52	50	45	44
Capital expenditure	(41.5)	(31.1)	(30.5)	(28.4)	(29.0)	Generation (GWh)	979	1,030	976	937	973
(Acquisitions)/divestments	118.2	8.1	0	0	0	NZ GWAP (\$/MWh)	2,235	1,995	1,758	1,896	1,896
Other	3.9	(1.7)	0	0	0	Mass market sales (GWh)	88	125	107	73	77
Funding available/(required)	288.2	95.6	55.1	103.6	117.3	TOU sales (GWh)	1,887	1,845	1,817	1,791	1,802
Dividends paid	(110.2)	(190.4)	(153.7)	(106.4)	(106.4)	Spot sales (GWh)	842	880	826	807	828
Equity raised/(returned)	(0.5)	0	0	0	0	Total Sales (GWh)	1,086	1,021	972	946	974
(Increase)/decrease in net debt	177.6	(94.8)	(98.5)	(2.8)	10.9	LWAP (\$/MWh)	3,815	3,746	3,615	3,544	3,605
						LWAP/GWAP	91	131	109	79	83
						Electricity customers (000)	1.04	1.04	1.01	1.08	1.07
						Usage/customer (MWh)	273	267	266	265	263
						Revenue/MWh sold (\$)	6.9	6.8	6.8	6.8	6.8
						Gas customers (000)	212	230	222	216	220
						Volume/customer (GJ)	37	39	41	42	43
						Telco customers (000)	27.5	26.5	24.8	24.8	24.8
						Revenue/customer (\$)	87	96	104	111	116
							991	963	959	968	978
Balance Sheet (NZ\$m)											
Working capital	2018A	2019A	2020E	2021E	2022E						
Fixed assets	(28.3)	(0.3)	20.5	23.3	25.3						
Intangibles	2,102.2	1,924.7	1,913.0	1,898.6	1,884.2						
Right of use asset	44.1	37.0	40.1	43.2	46.2						
Other assets	0	0	0	0	0						
Total funds employed	59.6	114.8	178.3	174.7	163.7						
Net debt/(cash)	2,177.6	2,076.2	2,151.9	2,139.8	2,119.3						
Lease liability	466.7	557.4	659.2	662.0	651.1						
Other liabilities	0	0	0	0	0						
Shareholder's funds	275.9	269.8	314.1	314.9	314.9						
Minority interests	1,412.9	1,224.4	1,153.6	1,136.2	1,125.0						
Total funding sources	22.0	24.6	25.0	26.6	28.3						
	2,177.6	2,076.2	2,151.9	2,139.8	2,119.3						

FY20 forecast

Figure 2. FY20 forecast

Year ending 31 March (\$m)	FY19	FY20	Change
Electricity	861	803	-7%
Other	169	172	2%
Total Revenue	1,030	976	-5%
Costs	(808)	(789)	-2%
EBITDAF	222	187	-16%
Depreciation and amortisation	(47)	(39)	-16%
EBIT	175	147	-16%
Fair Value Gains/(Losses)	(6)	(12)	
One-off items	(11)	(2)	
Net interest	(28)	(35)	
Pretax Profit	130	98	-25%
Tax	(38)	(29)	-22%
REPORTED PROFIT	93	69	-26%
Minority interests	(2)	(2)	
Profit Attributable to Shareholders	91	67	-26%
Abnormal items	12	11	
NORMALISED PROFIT	103	78	-24%
Earnings per share (cps)	32.8	24.8	-24%
Final ordinary dividend	17.0	17.0	
Dividend per share (cps)	34.0	34.0	0%

Source: TPW, Forsyth Barr analysis

Summary forecast changes

Figure 3. Summary forecast changes

	FY20 Old	FY20 New	Chg	FY21 Old	FY21 New	Chg	FY22 Old	FY22 New	Chg
	\$m	\$m	%	\$m	\$m	%	\$m	\$m	%
Revenue	983	976	-0.7%	988	937	-5.2%	994	973	-2.1%
EBITDAF	187	187	0.0%	207	203	-2.2%	217	213	-2.2%
EBIT	145	145	0.0%	168	163	-2.8%	177	172	-2.6%
NPAT	69	69	-0.1%	94	91	-3.9%	101	97	-3.8%
Normalised Profit	78	78	-0.1%	93	89	-3.9%	99	95	-3.8%
DPS	34.0	34.0	0.0%	34.0	34.0	0.0%	35.0	34.0	-2.9%
Generation volumes (GWh)	1,753	1,758	0.3%	1,896	1,896	0.0%	1,896	1,896	0.0%
Electricity Wholesale Price (\$/MWh)	\$102.3	\$81.1	-20.7%	\$88.6	\$81.0	-8.6%	\$89.3	\$77.4	-13.3%
Retail sales (GWh)	2,660	2,643	-0.6%	2,659	2,598	-2.3%	2,653	2,631	-0.9%

Source: Forsyth Barr analysis

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

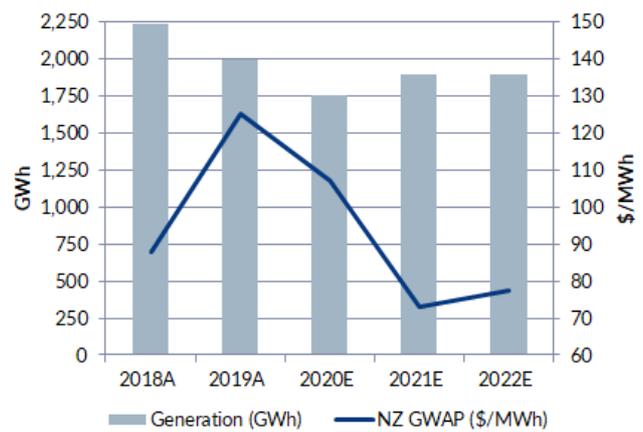
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance) and TPW will be among the least affected if it does.
- **Rising bond yields:** In recent years TPW has traded in line with 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 4. Retail sales volumes and average price received

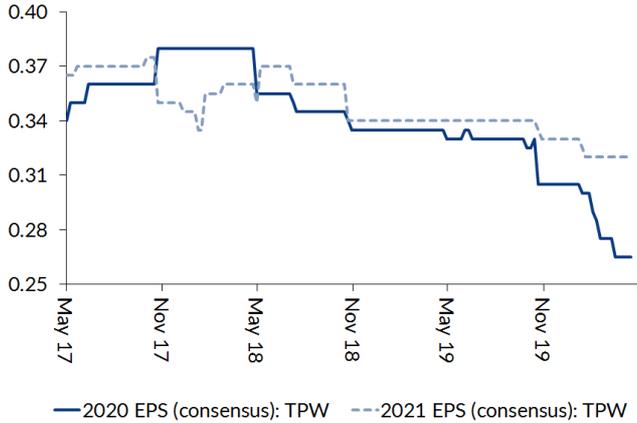


Source: TPW, Forsyth Barr analysis

Figure 5. Generation volumes and average price received



Source: TPW, Forsyth Barr analysis

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
Infratil	51.0%
TECT Holdings	26.8%

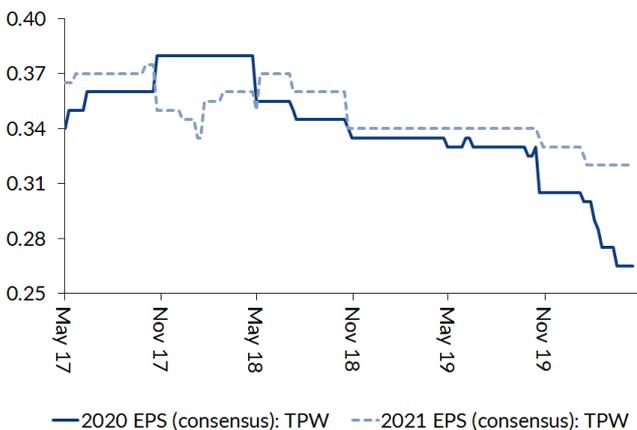
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 8. International valuation comparisons

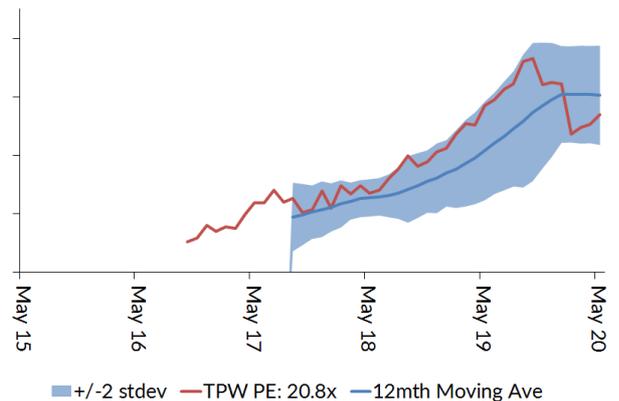
Company (metrics re-weighted to reflect TPW's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Trustpower	TPW NZ	NZ\$6.61	NZ\$2,069	24.7x	21.3x	14.0x	12.9x	17.8x	16.1x	5.1%
Contact Energy *	CEN NZ	NZ\$6.30	NZ\$4,524	19.1x	18.9x	12.1x	12.0x	23.3x	23.4x	6.2%
Genesis Energy *	GNE NZ	NZ\$2.85	NZ\$2,957	18.4x	16.0x	11.6x	10.7x	29.8x	26.5x	6.1%
Meridian Energy *	MEL NZ	NZ\$4.82	NZ\$12,354	24.8x	27.0x	16.0x	16.9x	24.7x	27.4x	4.5%
Mercury *	MCY NZ	NZ\$4.59	NZ\$6,246	26.9x	24.5x	14.8x	14.4x	25.2x	24.4x	3.5%
AGL ENERGY	AGLAT	A\$17.09	A\$10,752	13.0x	13.2x	6.5x	6.5x	9.9x	10.2x	5.7%
ORIGIN ENERGY	ORG AT	A\$4.89	A\$8,612	8.2x	15.5x	6.5x	6.1x	12.7x	18.0x	4.4%
Compco Average:				18.4x	19.2x	11.3x	11.1x	20.9x	21.6x	5.1%
TPW Relative:				34%	11%	25%	17%	-15%	-26%	2%

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 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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