

Tilt Renewables

Wholesale Pressure Offsets COVID Immunity

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OUTPERFORM 

In this Tilt Renewables (TLT) update, the lower outlook for electricity prices has pulled back our long-term forecasts such that we have lowered our target price -20cps (-5.4%) to NZ\$3.50. Nevertheless, we still like TLT's investment case. It is largely immune to the effects of COVID-19, has a strong development track record, a strong development pipeline, and is returning ~NZ\$0.59/share in the coming months due to the successful sale of Snowtown 2. Our rating is OUTPERFORM.

NZX Code	TLT	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$3.20	NPAT* (NZ\$m)	75.1	77.0	60.9	57.0	EV/EBITDA	13.9	12.4	11.2	10.1
Target price	NZ\$3.50	EPS* (NZc)	16.0	16.4	13.0	12.2	EV/EBIT	36.6	2.8	19.8	32.7
Risk rating	Low	EPS growth* (%)	-2.2	2.5	-21.0	-6.3	PE	20.0	19.5	24.7	26.3
Issued shares	469.5m	DPS (NZc)	1.1	0.0	0.0	0.0	Price / NTA	5.5	5.5	5.5	5.4
Market cap	NZ\$1,502m	Imputation (%)	0	0	0	0	Cash div yld (%)	0.4	0.0	0.0	0.0
Avg daily turnover	45.9k (NZ\$133k)	*Based on normalised profits					Gross div yld (%)	0.4	0.0	0.0	0.0

Falling wholesale electricity prices not helpful, but LGC prices holding up well

Spot wholesale and future electricity prices on both sides of the Tasman have been under pressure in recent months. Whilst most of TLT's generation for the next decade will be sold at a fixed price (~75% in Australia, 100% in New Zealand), it still has some spot price exposure – primarily Snowtown 1 and Salt Creek LGCs. Future Australian electricity prices are ~A\$55/MWh, a record low. Whilst these futures prices suggest the market is oversupplied, in our view they are too low vs. the costs of building new firm electricity and will, therefore, rise in time. In contrast to wholesale electricity prices, renewable energy certificate prices (LGCs) have held up well, with 2021 and 2022 contracts at, or close to, 12 month highs.

TLT largely immune to COVID-19

Notwithstanding the falls in wholesale electricity prices, TLT is largely immune to COVID-19. It has very low counter-party risk and sells all the electricity it generates. i.e. it is not exposed to COVID-19 related falls in electricity demand. In addition, low interest rates help reduce the cost of funding future projects. TLT is a very low risk business with a strong track record.

Cash heading back to shareholders in near future – more Snowtown 2 type deals possible in the future

As expected, TLT has announced it is returning ~A\$260m (~A\$0.55/share, ~NZ\$0.59/share) to shareholders. The timetable is subject to court timetables, but TLT is hopeful capital return should be with shareholders before the end of the current quarter. The cash came from the sale of TLT's Snowtown 2 wind farm in December 2019 and subject to market conditions on completion, it is possible TLT could repeat the process with the under construction Dundonnell or Waipipi wind farms.

Forecast changes reflect actual volumes and pricing outlook

We have lowered our FY20 EBITDAF forecast -6% to A\$117m due to the low wholesale electricity prices in 4Q20 and slightly lower than assumed generation volumes. Our new forecast is consistent with TLT guidance. TLT is reporting its FY20 result on Monday 25 May. We have also dropped our FY21/FY22 EBITDAF forecasts -4%/-8% due to the lower wholesale electricity price outlook in Australia. Our long-term Australian wholesale electricity price assumption is ~A\$65/MWh, down from ~A\$73/MWh. The material fall in the wholesale electricity price outlook is the driver of the -20cps (-5.4%) cut in our target price to NZ\$3.50.

Tilt Renewables Limited (TLT)

Priced as at 30 Apr 2020 (NZ\$)

3.20
12-month target price (NZ\$)*
3.50

Expected share price return

9.4%

Net dividend yield

0.0%

Estimated 12-month return

9.4%

Spot valuations (NZ\$)

1. DCF

3.15

2. Multiple

3.60

3. n/a

n/a

Key WACC assumptions

Risk free rate

2.00%

Equity beta

0.94

WACC

7.4%

Terminal growth

1.5%

DCF valuation summary (NZ\$m)

Total firm value

1,908

(Net debt)/cash

(428)

Less: Capitalised operating leases

Value of equity

1,480

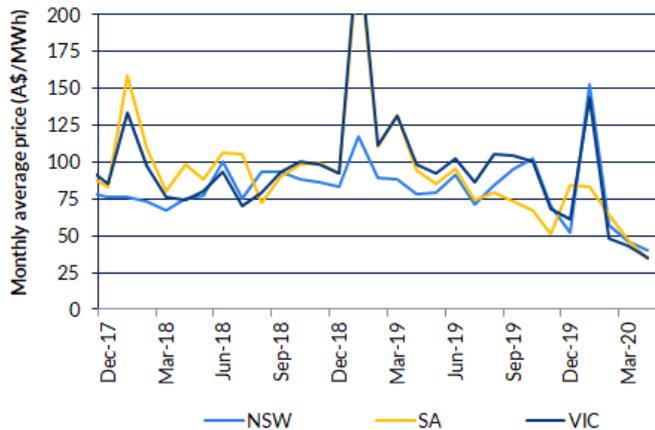
Profit and Loss Account (A\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	158.0	193.3	177.6	165.2	189.2	EV/EBITDA (x)	18.8	13.9	12.4	11.2	10.1
Normalised EBITDA	103.8	134.8	117.1	98.3	107.8	EV/EBIT (x)	72.9	36.6	2.8	19.8	32.7
Depreciation and amortisation	(77.1)	(83.6)	(56.4)	(42.5)	(74.5)	PE (x)	19.6	20.0	19.5	24.7	26.3
Normalised EBIT	26.8	51.2	516.7	55.8	33.4	Price/NTA (x)	n/a	5.5	5.5	5.5	5.4
Net interest	(29.4)	(30.1)	(9.1)	(10.3)	(25.9)	Free cash flow yield (%)	3.2	5.3	3.0	6.3	6.2
Other	26.3	(2.0)	(10.0)	0	0	Net dividend yield (%)	1.0	0.4	0.0	0.0	0.0
Tax	(6.6)	(6.9)	(11.6)	(13.4)	(2.2)	Gross dividend yield (%)	1.0	0.4	0.0	0.0	0.0
Depreciation capex adjustment	48.6	56.6	36.2	26.1	48.6						
Normalised NPAT	47.3	70.1	73.3	58.2	53.8	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	(30.3)	(58.0)	412.8	(26.1)	(48.6)	Interest cover EBIT (x)	0.9	1.7	57.0	5.4	1.3
Reported NPAT	17.0	12.2	486.1	32.1	5.3	Interest cover EBITDA (x)	3.5	4.5	12.9	9.6	4.2
Normalised EPS (cps)	15.1	14.9	15.6	12.4	11.5	Net debt/ND+E (%)	53.8	36.0	-42.2	-2.3	-11.5
DPS (cps)	3.1	1.1	0	0	0	Net debt/EBITDA (x)	5.7	2.7	n/a	n/a	n/a
Growth Rates	2018A	2019A	2020A	2021A	2022A	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	n/a	n/a	n/a	n/a	n/a	Return on assets (%)	2.0	3.3	25.4	2.3	1.4
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	Return on equity (%)	9.3	10.7	6.6	5.1	4.7
EBIT (%)	n/a	n/a	n/a	n/a	n/a	Return on funds employed (%)	1.7	3.5	5.5	3.5	2.3
Normalised NPAT (%)	3.9	-52.3	>100	-93.4	-83.5	EBITDA margin (%)	65.7	69.7	66.0	59.5	57.0
Normalised EPS (%)	-41.9	-47.5	-100.0	n/a	n/a	EBIT margin (%)	16.9	26.5	290.9	33.8	17.6
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	52.9	47.0	218.0	245.9	3.7
						Capex to depreciation (%)	108	109	686	956	9
Cash Flow (A\$m)	2018A	2019A	2020E	2021E	2022E	Imputation (%)	0	0	0	0	0
EBITDA	103.8	134.8	117.1	98.3	107.8	Pay-out ratio (%)	20	7	0	0	0
Working capital change	(18.9)	0.6	1.6	(2.3)	2.3						
Interest & tax paid	(41.9)	(41.7)	(20.3)	4.3	(9.4)	Operating Performance	2018A	2019A	2020E	2021E	2022E
Other	13.9	(8.6)	(47.2)	0	0	Australia installed capacity (MW)	386	440	305	506	506
Operating cash flow	56.9	85.0	51.3	100.3	100.8	NZ installed capacity (MW)	197	197	197	197	330
Capital expenditure	(83.6)	(90.8)	(387.2)	(406.3)	(7.0)	TLT installed capacity (MW)	583	637	502	703	836
(Acquisitions)/divestments	0	0	1,056.0	0	0	Australia wind generation (GWh)	1,225	1,395	1,170	1,375	1,771
Other	0	0	0	0	0	NZ wind generation (GWh)	571	658	664	672	1,119
Funding available/(required)	(26.7)	(5.8)	720.1	(306.0)	93.8	TLT wind generation (GWh)	1,796	2,053	1,834	2,047	2,890
Dividends paid	(11.0)	(10.6)	0	0	0						
Equity raised/(returned)	(0.1)	259.9	(1.0)	0	0	Price assumptions					
(Increase)/decrease in net debt	(37.7)	243.5	719.1	(306.0)	93.8	Australia REC price (A\$/MWh)	83.3	78.3	62.1	29.0	23.7
						SA wholesale price (A\$/MWh)	69.0	86.6	84.5	65.7	59.8
Balance Sheet (A\$m)	2018A	2019A	2020E	2021E	2022E	VIC wholesale price (A\$/MWh)		104.6	110.3	71.5	61.6
Working capital	17.9	14.3	13.6	15.9	13.6	Australia PPA price (A\$/MWh)	98.3	94.2	93.3	57.7	57.8
Fixed assets	1,170.6	1,066.7	915.9	1,279.7	1,212.2	NZ PPA price (NZ\$/MWh)	65.1	64.8	64.0	65.1	66.4
Intangibles	0.6	0.5	0.5	0.5	0.5						
Right of use asset	0	0	0	0	0	Australia spot sales (GWh)	23	155	365	931	458
Other assets	100.5	114.3	73.6	73.6	73.6	Australia PPA sales (GWh)	1,202	1,239	805	444	1,313
Total funds employed	1,289.6	1,195.9	1,003.7	1,369.8	1,300.0	Australia spot revenue (A\$m)	3	34	61	65	28
Net debt/(cash)	593.1	369.3	(331.4)	(25.4)	(119.1)	Australia PPA revenue (A\$m)	118	117	75	26	76
Lease liability	0	0	0	0	0	Australia revenue (A\$m)	122	151	136	123	118
Other liabilities	186.3	170.6	218.7	246.7	265.4	NZ revenue (A\$m)	36	42	42	43	71
Shareholder's funds	510.2	656.0	1,116.3	1,148.4	1,153.7						
Minority interests	0	0	0	0	0	Australia EBITDAF (A\$m)	82	109	92	73	62
Total funding sources	1,289.6	1,195.9	1,003.7	1,369.8	1,300.0	NZ EBITDAF (A\$m)	22	25	25	25	46

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

Australian wholesale electricity prices – April prices low and futures price sink further

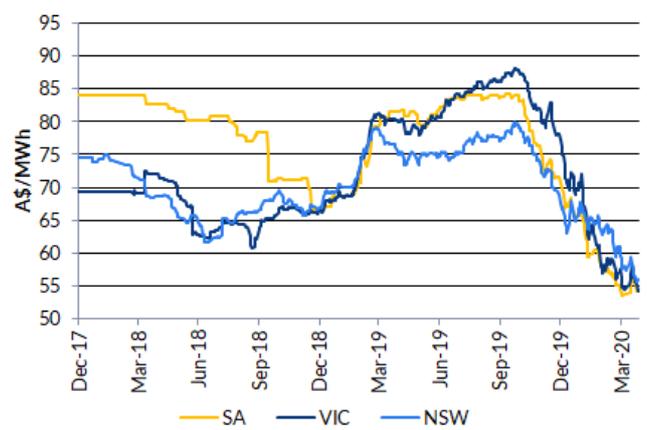
Australian wholesale electricity prices have been sliding for the past three months. The average April 2020 wholesale electricity price across New South Wales, South Australia and Victoria averaged ~A\$35/MWh with electricity demand impacted by COVID-19. Prices in February and March were also below average. The futures prices have demonstrated an even sharper decline and are currently ~A\$55/MWh, record lows. The market is indicating it is oversupplied, not helped by the demand effects of the bushfires and COVID-19. In our view the current futures price is below the cost of building firm new generation. Whilst wind farms and solar farms can be built for A\$55/MWh, that generation needs to be firmed – so we are not as bearish long-term.

Figure 1. Monthly average wholesale electricity prices



Source: AEMO, Forsyth Barr analysis

Figure 2. 12-mth forward futures prices



Source: Eikon, Forsyth Barr analysis

Renewable energy certificate prices (LGCs) holding firm

In contrast to wholesale electricity prices, LGC prices have held up well, with 2021 and 2022 contracts firming as there are increasing concerns that some planned new developments will be deferred, tightening the LGC market.

Figure 3. Renewable energy certificate prices



Source: Bloomberg, Forsyth Barr analysis

4Q20 generation

Figure 4. 4Q20 generation

	Quarterly production			Year-to-date generation			
	4Q19	4Q20	Diff to pcp	FY19	FY20	Diff to Avg	Diff to pcp
NZ	150	153	2%	658	664	-1%	1%
Australia	314	128	-59%	1,395	1,170	-2%	-16%
TLT	464	281	-39%	2,053	1,834	-1%	-11%

Source: TLT, Forsyth Barr analysis

Note: The drop in Australian generation is due to the sale of Dundonnell in December 2019. On a like-for-like basis, Australian 4Q20 generation was up +8% on the pcp

Forecast changes

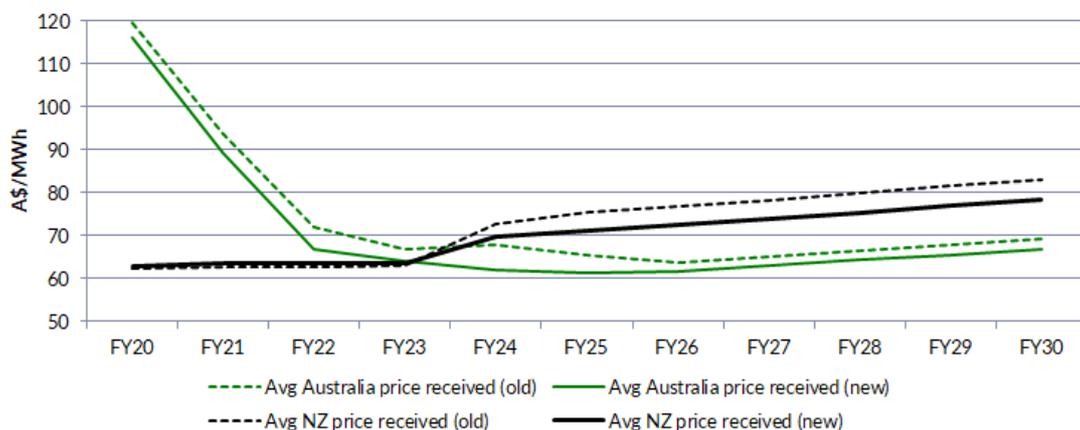
Figure 5. Forecast changes

	FY20 Old A\$m	FY20 New A\$m	% Chg	FY21 Old A\$m	FY21 New A\$m	% Chg	FY22 Old A\$m	FY22 New A\$m	% Chg
Australia revenue	144	136	-6%	127	123	-3%	128	118	-7%
NZ revenue	42	42	1%	42	43	1%	70	71	1%
Total Revenue	186	178	-4%	169	165	-2%	198	189	-4%
Operating costs	(61)	(60)	-1%	(66)	(67)	1%	(81)	(81)	0%
Australia EBITDAF	100	92	-8%	78	73	-6%	71	62	-13%
NZ EBITDAF	25	25	1%	25	25	1%	46	46	1%
EBITDAF	125	117	-6%	103	98	-4%	117	108	-8%
Depreciation & amortisation	(56)	(56)	0%	(43)	(43)	0%	(74)	(74)	0%
EBIT	68	61	-11%	60	56	-7%	42	33	-21%
Fair value gain/(loss) & other	446	446		0	0		0	0	
Interest costs	(9)	(9)	-1%	(10)	(10)	1%	(26)	(26)	0%
Pre-tax profit	505	498	-1%	50	46	-9%	17	7	-55%
Tax expense	(14)	(12)	-16%	(15)	(13)	-9%	(5)	(2)	-55%
Reported NPAT	491	486	-1%	35	32	-9%	12	5	-55%
Normalised NPAT	42	37	-12%	35	32	-9%	12	5	-55%
EPS	9.0	7.9	-12%	7.5	7.0	-6%	2.5	4.1	63%
DPS	0.00	0.00		0.00	0.00		0.00	0.00	
Australia generation (GWh)	1,208	1,170	-3%	1,350	1,375	2%	1,771	1,771	0%
NZ generation (GWh)	665	664	0%	672	672	0%	1,119	1,119	0%
Total generation (GWh)	1,874	1,834	-2%	2,022	2,047	1%	2,890	2,890	0%
Australian sales price (A\$/MWh)	119	116	-3%	94	89	-5%	72	67	-7%
NZ sales price (A\$/MWh)	62	63	1%	63	63	1%	63	63	1%
Weighted avg price (A\$/MWh)	99	97	-2%	83	81	-3%	69	65	-4%

Source: Forsyth Barr analysis

TLT's key value driver is the price it receives for its generation. The prices noted below reflect the average price received per MWh generated and includes LGCs (where relevant), power purchase agreement (PPA) fixed prices, wind discount factors as well as the assumed wholesale electricity price.

Figure 6. Average electricity price received - assumption change



Source: Forsyth Barr analysis

Investment Summary

Our rating is OUTPERFORM. TLT offers exposure to renewable energy developments, particularly in Australia. It has a strong pipeline and excellent development track record. In addition, the low interest rate environment is attractive for low cost funding and we believe it is largely immune to COVID-19 downside risks.

Business quality

- **Strong development pipeline:** TLT has a large portfolio of renewable energy development options, predominantly in Australia. Most of the options are wind, but also include solar, pumped hydro, and batteries. The total pipeline is over 3,000MW.
- **Excellent development track record:** TLT's development track record is very good, with projects typically coming in on time and at/below budget. It has also demonstrated an ability to attract strong offtake partners.

Earnings and cashflow outlook

- **Long-term growth from new developments:** TLT's earnings outlook is positive as its wind farm developments come to fruition. However, LGC prices are falling which will temper near-term earnings growth.
- **Mix of fixed prices and wholesale price exposure:** Most of TLT's developments have long-term fixed price offtake agreements, providing a reliable earnings stream. However, it also has some (~30%) long-term exposure to wholesale electricity prices in Australia.

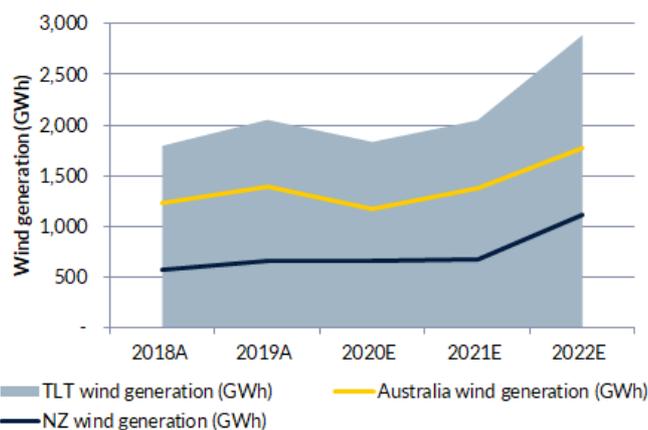
Financial structure

- **Strong balance sheet following sale of Snowtown 2:** We estimate that TLT has surplus capital of more than A\$275m following the successful sale of its Snowtown 2 wind farm and A\$260m capital return to shareholders.

Risk factors

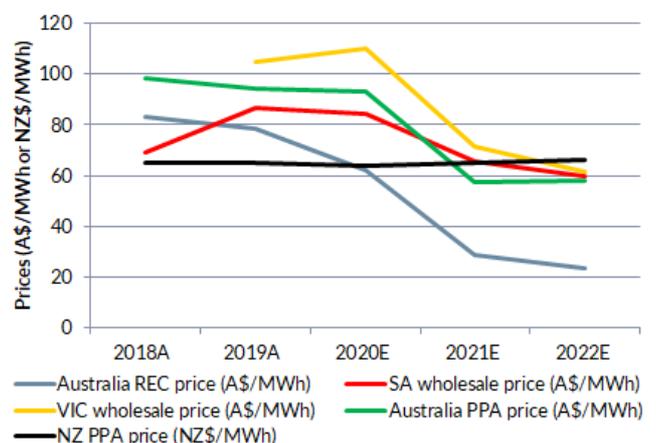
- **Competing developers with low cost of capital requirements:** The power purchase agreement (PPA) market at present is well below A\$60/MWh, with the low end of the range partly driven by low return requirements. TLT could be outbid if low return expectations become the norm, limiting the value upside from new developments.
- **Regulatory uncertainty:** Whilst renewable electricity generation is going to be a core part of Australia decarbonising its economy, there is significant policy uncertainty. In addition, electricity prices are a politically sensitive topic, adding to the uncertainty.

Figure 7. Generation volumes



Source: TLT < Forsyth Barr analysis

Figure 8. Pricing assumptions



Source: TLT, Forsyth Barr analysis

Figure 9. Price performance


Source: Bloomberg, Forsyth Barr analysis

Figure 10. Substantial shareholders

Shareholder	Latest Holding
Infratil	65.3%
Mercury NZ Ltd	20.0%

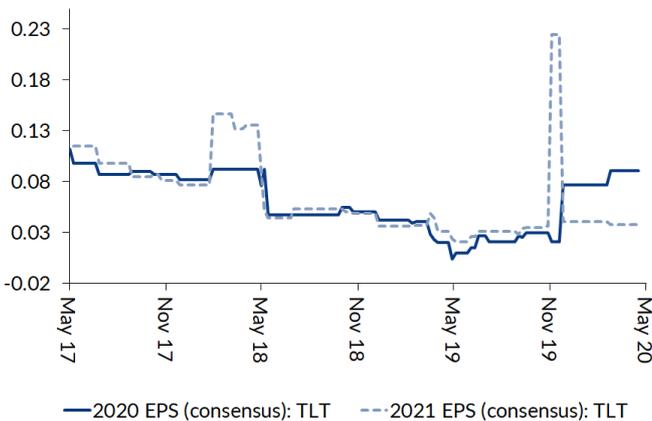
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 11. International valuation comparisons

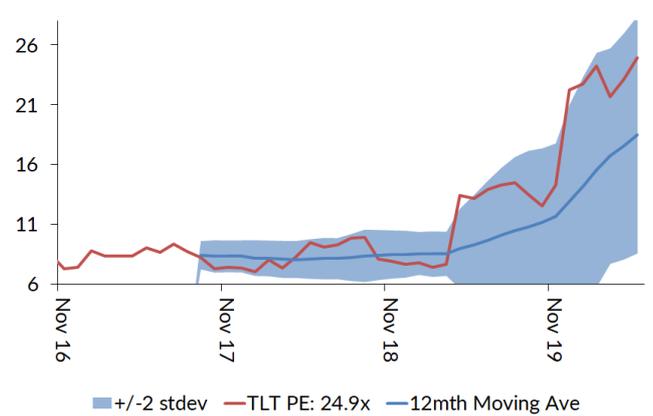
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
(metrics re-weighted to reflect TLT's balance date - March)										
Tilt Renewables	TLT NZ	NZ\$3.20	NZ\$1,502	19.5x	24.7x	15.3x	18.4x	3.5x	32.3x	0.0%
Trustpower*	TPW NZ	NZ\$6.32	NZ\$1,978	23.5x	19.7x	13.5x	12.2x	17.1x	15.1x	5.4%
Contact Energy*	CEN NZ	NZ\$6.30	NZ\$4,524	18.6x	18.5x	11.9x	11.7x	22.4x	22.7x	6.2%
Genesis Energy*	GNE NZ	NZ\$2.85	NZ\$2,957	18.0x	15.8x	11.5x	10.7x	28.6x	26.0x	6.1%
Meridian Energy*	MEL NZ	NZ\$4.82	NZ\$12,354	24.9x	26.7x	16.1x	16.8x	24.9x	27.1x	4.5%
Mercury*	MCY NZ	NZ\$4.59	NZ\$6,246	26.4x	23.8x	14.6x	14.1x	24.6x	23.6x	3.5%
INFIGEN ENERGY	IFN AT	A\$0.53	A\$514	13.5x	15.5x	6.4x	6.6x	10.3x	11.4x	3.8%
Compc Average:				20.8x	20.0x	12.3x	12.0x	21.3x	21.0x	4.9%
TLT Relative:				-6%	23%	24%	53%	-84%	54%	-100%

EV = Current Market Cap + Actual Net Debt

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

Figure 12. Consensus EPS momentum (NZ\$)


Source: Bloomberg, Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Bloomberg, Forsyth Barr analysis

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OUTPERFORM	NEUTRAL	UNDERPERFORM
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