Woodward Partners

1 October 2013

Meridian Energy Limited (MEL.NZ)

Risk-averse team + low-cost generation + strong cash flows + low gearing = a conservative investment

We consider Meridian Energy is a conservative investment and we forecast it paying a growing dividend. While the company does face risks, notably South Island hydrology, management maintains a conservative balance sheet and a cautious outlook on new investments. We forecast Meridian's fleet of low-cost generating plants will produce strong cash flows, and we forecast a dividend of $0.11 in F2014 and $0.12 per share in F2015. We value the company at $1.81 per share today, meaning the $1.60 per share price cap for retail investors is an attractive price to pay for Meridian Instalment Receipts.

Meridian is 90% hydro, and hydro is a two-edged sword in NZ

Meridian is the country's largest generator, and 90% of its output is hydro with six power plants on the Waitaki river and the Manapouri station, all in the South Island. The company has contracted 40% of its output to the Tiwai Point aluminium smelter. During dry years, Meridian's generation has come-up short, requiring the company to meet its contractual load to its 273,000 customers and to Tiwai Point by purchasing power on the spot market when prices are high. Meridian is more susceptible to droughts than the other generators, and dry years could reduce cash flows, earnings and dividends.

Meridian's key risks are dry years and slowing demand growth

We have considered ten risks, and consider the two most serious are droughts in the South Island, followed by lower wholesale prices and retail competition.

New transmission pricing should be good news for Meridian

New proposed transmission pricing is expected in 2014, although its structure, timing and quantum is unknown. We expect Meridian to be no worse off than it is now, and the new pricing quite likely represents upside for the company.

Meridian is signalling a smoothed dividend policy

The company says it plans to reduce dividend shocks by targeting a dividend yield rather than a payout ratio.

Year to 30 June		FY12A	FY13A	FY14F	FY15F	FY16F
Revenue	($m)	2,570	2,711	2,440	2,559	2,756
EBITDAF	($m)	476	585	548	590	671
NPAT	($m)	75	295	188	211	275
P/E @ $1.81	(x)	n/a	n/a	24.8	22.1	17.0
EPS	(¢)	2.9	11.5	7.3	8.2	10.7
EV/EBITDAF	(x)	8.9	12.8	10.2	10.5	10.0
Payout ratio	(%)	61	106	143	140	116
DPS	(¢)	2.8	9.8	10.5	11.5	12.5
Dividend yield (cash) @ 1.60	(%)	n/a	n/a	6.5	7.2	7.8
Dividend yield (cash) @ 1.81	(%)	n/a	n/a	5.6	6.4	7.0
Dividend yield (gross) @ 1.81	(%)	n/a	n/a	7.3	8.1	8.7

Our View

Shares (basic)	2,563m
Shares (fully diluted)	2,563m
Valuation per share	$1.81
12-month target price	$2.10
Forecast dividend in FY2014	¢/share 11
Forecast dividend in FY2015	¢/share 12

Ticker	MEL
Bloomberg	MEL NZ
Reuters	MEL.NZ

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Overview of the New Zealand Electricity Sector

New Zealand's electricity sector is close to being fully-deregulated

Most countries that have fully deregulated their electricity sectors have required the complete separation of generation assets from the other major elements of the sector - the high-voltage transmission lines, low-voltage distribution lines, customers and ancillary services. But in New Zealand, the electricity regulations allow, even promote, having generation and customers under the same roof to create generation-retailers, or gentailers. This creates a natural and internal hedge against the price volatility typically associated with competitive wholesale power markets – when the price of wholesale electricity is high, the generation side of the company that sells power earns higher revenues but the retail side (as the buyer of power) pays more, so revenues and earnings are smoothed despite volatile wholesale prices.

Meridian Energy will list on the NZX Main Board in October 2013

Meridian is the second of three gentailers scheduled to be partially privatised

The current National Party government, now well into its second three-year term, is following-through with its intentions to list three state-owned enterprises (SOEs) in the electricity sector on the NZX and ASX stock exchanges. The first was Mighty River Power in May 2013, and Meridian will come to market on 29 October 2013. The government has stated it plans to list Genesis Energy during the first half of 2014.

New Zealand has the second-highest percentage of renewable energy

Blessed with significant hydro potential, geothermal and wind potential, New Zealand already generates more than 70% of its electricity from renewable sources (according to the Energy Efficiency and Conservation Authority – EECA), second only to Norway. The balance of electricity is generated from traditional fossil fuels, mostly coal, natural gas, and small amounts of diesel fuel.

While most electricity is hydro generated, there is limited water storage

More than half of the electricity consumed in New Zealand is generated at hydro stations in the North and South Island. Most hydro power stations are 'run of river' rather than reservoir–fed, and there is limited storage capacity because the lakes are generally not very deep. However, Meridian has storage equivalent to 2,200GWh of electricity, or 48% of New Zealand's total hydro storage, most of this is in the Waitaki hydro system. Nevertheless, a few weeks of low rainfall can significantly reduce that stored water. Consequently, river flows and lake levels are strictly managed to serve the requirements of not only power generation but also agricultural irrigation and recreation. The country's heavy dependence on hydro generation coupled with its low storage capacity means that rainfall and snowmelt dictate hydro generating capacity and therefore drive wholesale power prices. Meridian is the major South Island hydro generator and Mighty River Power is in a similar position in the North Island, albeit to a lesser degree.

Generators bid into the wholesale power market every half-hour

With five large generators competing for market share, New Zealand's generation sector is very competitive

Each generator submits its bid at which it will sell wholesale power for each half-hour period. Transpower ranks the generators from lowest to highest, and the last generator needed to meet the needs for that period sets the price that all the generators receive. During periods of low demand (such as weekends), only low-cost plants are needed to satisfy the low demand so the spot price is also low. When demand is high (such as during cold winter days), more expensive thermal plants are also needed to satisfy the greater demand, and the spot market price is higher.

Transpower's high-voltage network carries electricity from the power stations

Each power station is connected to the rest of the country via the high-voltage network (or national grid) owned and operated by Transpower. The grid carries the bulk electricity to the distribution networks and to large industrial customers. Transpower also dispatches power stations to meet changing customer demand. An important part of Transpower's network is the high voltage, direct current (HVDC) cable that links the North and South Islands. Transpower has invested more than $2 billion in upgrading the network and HVDC line, which is expected to reduce outages and system constraints, but also means higher transmission costs passed on to consumers.

The 29 distribution companies deliver electricity to each customer

The distribution networks receive bulk power from the grid via substations where step-down transformers reduce the voltage ready for distribution to residential, commercial and smaller industrial customers. Most of the distribution networks are owned by local councils and trusts, although Vector and Horizon Energy are listed on the NZX Main Board, and Wellington Electricity Lines is owned by Hong Kong-based Cheung Kong Infrastructure (CKI) Holdings.

Twenty-two retailers compete to sell electricity to customers

Extensive competition among retailers creates ample choice for consumers

New Zealand has approximately two million electricity customers that include retail (households), commercial (office buildings), industrial (manufacturing) and agricultural consumers. There are 22 registered retailers that buy electricity from the wholesale market and sell it to customers at whatever prices they want to offer. In 2009, the electricity sector regulator, the Electricity Authority (EA), launched the website '*What's My Number*' to encourage retail customers to shop around for the best price and service. That created significant customer churn, which remains at approximately 20% per year today. Meridian owns two of the registered retailers, its own brand and the Powershop brand.

The Electricity Authority has primary regulatory oversight of the electricity sector

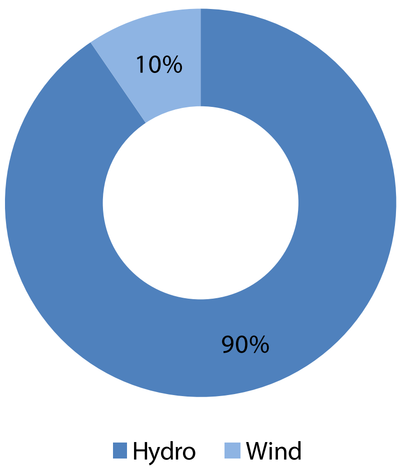
The EA enforces the various rules and regulations to help ensure that the wholesale and retail markets remain competitive. A second regulatory body, the Commerce Commission, approves capital expenditure requests from Transpower and ensures that the network companies do not abuse their natural monopolies.

Meridian is the largest generator in New Zealand

Meridian has the most hydro-generation

Meridian has 2,768 MW of total capacity, of which 2,338 MW (85%) is South Island hydro. The company owns and operates six hydro stations on the Waitaki hydro scheme plus the Manapouri station that was built to supply the Tiwai Point aluminium smelter, representing approximately 40% of its total output. To encourage more geographic competition, the EA required Meridian to sell its Tekapo A and B hydro stations to Genesis Energy in 2011. Meridian has also divested or closed several other businesses that were not contributing meaningfully to earnings but were a distraction for management. Today, the company focuses on its core expertise of hydro and wind.

Figure 1 – Meridian Energy generation mix in FY2013



Source: Meridian Energy Prospectus

Meridian has also invested heavily in wind generation

The company owns and operates four wind farms in New Zealand, and is developing a new 60MW wind farm, Mill Creek, near Wellington. In Australia, Meridian was partnering with AGL Energy to build the 420 MW Macarthur wind farm in Victoria, but has agreed to sell its share. The company continues to operate its 70MW Mt. Millar wind farm in South Australia, and says it intends to construct and operate its 131MW Mt Mercer wind farm in Victoria.

Table 1 – Meridian's wind farms

Name	Capacity (MW)	Commissioned
Te Uku	64	2010
West Wind	143	2009
Te Apiti	91	2004
Mill Creek	60	Expected 2014
White Hill	58	2007
Mt Millar (Aus)	70	2006
Mt Mercer (Aus)	131	Expected 2014

Source: Meridian Energy Prospectus

Meridian has virtual asset swaps (VAS) with Mighty River Power and Genesis Energy

Under the swaps, no physical electricity actually changes hands between the companies. Instead, for example, the VAS with MRP requires Meridian to sell the financial equivalent of up to 700 GWh of electricity per year to MRP priced at the Benmore node in the South Island. In return, MRP sells the financial equivalent of up to the same volume to Meridian priced at the North Island node of Whakamaru. These swaps were introduced to encourage the three gentailers to seek customers outside of their legacy regions of operations, the North Island for MRP and Genesis, and the South Island for Meridian.

Meridian sells electricity to customers under two distinct retail brands

Meridian uses its own brand and the Powershop brand to sell electricity to consumers

Meridian retails electricity under two brands, the Meridian brand (222,000 customers) and the Powershop brand (with 51,000 customers). Powershop recently launched in Victoria, Australia as well. With approximately 273,000 total customers, Meridian is the fourth largest retailer, and Powershop has been the fastest-growing retailer, and among the fastest growing companies in New Zealand (as ranked in Deloittes Fast 50 index in 2012). That said, and as with all of the gentailers, Meridian has experienced increased retail competition with the advent of the EA's '*What's My Number*' campaign.

Meridian and NZAS, owner of Tiwai Point, recently signed a new agreement

The country's single biggest electricity consumer is the Tiwai Point smelter near Bluff. Meridian and Rio Tinto (which owns 79% of Tiwai Point in partnership with Sumitomo Chemicals) recently announced they have agreed to a new 'contract for differences' (CfD) that, among other rights, gives NZAS the right to reduce its obligation to purchase power from 572 MW to 400 MW. NZAS can also cancel the CfD in 2017. In return, Meridian has the right to require the smelter to reduce the amount of electricity it takes when lake levels are low and prices are high. We discuss the risks that we consider the new CfD represents to Meridian's dividends on page 9.

The company has been geographically diversifying its customer base

Meridian was traditionally the South Island-focussed hydro generator with the largest single customer in New Zealand, the Tiwai Point aluminium smelter. However, the company has diversified its customer base geographically, and today reports that its 220,000 customers are close to evenly split between the North and South Islands.

Meridian's key investment considerations

This report assumes most of Meridian's retail investors will buy and hold their shares and collect dividends over the long term so the report focusses on the risks that could impact dividends

The dividend is key to long-term, buy-and-hold, investors

This research report was prepared with retail investors in mind. Many (but certainly not all) such investors often invest in infrastructure companies such as in the electricity sector for the long term, seeking the income offered by regular dividend payments. Therefore, we have focussed our analysis on Meridian's dividend, its relative yield compared to other yield-oriented stocks, and on the various risks that could impact dividend payments in the future.

Meridian is the lowest-cost generator in New Zealand

With its low-cost hydro generation, Meridian can usually be assured of dispatching its seven hydro generators into the wholesale market, provided there are no restrictions on the use of water (during periods of low rainfall/snowmelt). As such, its generation fleet is well-positioned to earn revenues most of the time.

The company has strong and stable cash flows

The combination of low-cost generation, a long-term contract with a large industrial customer (Tiwai Point), and 273,000 customers across both islands generates strong and stable revenues and cash flows, in turn meaning the company's dividends are also reasonably predictable.

Meridian has a conservatively-geared balance sheet

Meridian has assets of $7.7 billion (largest in the electricity industry) but only $1.2 billion of total debt, resulting in a low gearing ratio of 16%, conservative compared to the other gentailers (typically with gearing ratios of 30%). This means Meridian has an enhanced ability to weather financial shocks, which serves to protect the dividend.

Meridian has a track record of developing and monetising projects in Australia

In 2005, Meridian sold its Southern Hydro Group for a gain of $625 million. In 2010, it entered into a joint venture with AGL Energy to build the 420 MW, A$1 billion Macarthur wind farm in Victoria, the largest wind farm in the Southern Hemisphere. Macarthur was commissioned earlier this year, and Meridian subsequently sold its 50% interest to a Malaysian company, Malakoff Corporation Berhad, booking a pre-tax profit of $101m.

Several risks could impact Meridian's dividend

Risk is the potential impact of an event times its likelihood of occurrence

We have assessed ten risk factors (see Table 2 below) and discussed each factor in the correspondingly numbered paragraphs that follow. The risks are listed in descending order of our assessment of their potential risk to Meridian's dividend over the next three years, where the potential risk to the dividend (1 to 25) is the likely impact on the dividend (1 to 5) times the likelihood of occurrence in the next three years (1 to 5).

Table 2 – Our estimate of potential risks to Meridian's dividend over next three years

	Type	Risk Factor	Impact on Dividend (1 to 5)	Likelihood in Next 3 Years (1 to 5)	Potential Risk to Dividend (1 to 25)
1	Fuel & generation	There could be low rainfall and/or low snowmelt in the South Island	5	4	20
2	Demand	Wholesale electricity prices could drop further	4	4	16
3	Regulatory/ political	The Labour and Green proposals could be enacted	5	3	15
4	Demand	Retail competition could increase	3	4	12
5	Regulatory/ political	A price for the use of water could be introduced	3	3	9
6	Demand	The economy could grow at a slower rate	2	3	6
7	Demand	Consumption by retail customers could grow at a slower rate	2	2	4
8	Financial	More capital could be needed in Australia	2	2	4
9	Financial	The government's 51% ownership could limit future equity raisings	2	2	4
10	Demand	The Tiwai Point smelter could close	3	1	3

Source: Woodward Partners

Key
High risk 18 to 25
Moderate risk 9 to 17
Low risk 1 to 9

1. There could be low rainfall and/or low snowmelt in the South Island - High risk

Drought remains the single biggest risk to Meridian's dividend because of the company's concentrated reliance on the flows on the Waitaki River

Meridian generates 90% of its electricity from seven hydro dams on the Waitaki River and below Lake Manapouri. During droughts, such as during the first half of 2013, water flows are often curtailed, limiting Meridian's ability to meet it's internal demand on its retail business and obligations to Tiwai Point. Such conditions require Meridian to purchase the difference from the wholesale market at a time when prices are likely to be higher than average. We consider this condition to be a high risk over the next three years.

2. Wholesale electricity prices could drop further – Moderate risk

New Zealand's total monthly peak demand is usually between 5,000 MW and 6,200 MW, yet there is approximately 10,000 MW of total generating capacity, meaning the system is currently in an over-supply condition. This has created low average wholesale prices, contributing to lower revenues for the generation side of the gentailers, including Meridian. As discussed above, the retail side of the gentailers, as the buyers, benefit from low wholesale prices. However, Meridian has slightly more generation capacity than it needs to satisfy its contracted demand (termed as being 'long' generation), and it sells its excess supply on the spot market. Therefore, low prices have the net effect of reducing the company's revenues and cashflows. Given that the over-supply market condition will likely last for five or more years, we consider this to be a moderate risk for Meridian. However, Genesis' recent announcement to bring forward the timing of their mothballing of a second 250MW unit at Huntly by December 2013 will reduce some of the oversupply sooner in the market.

3. The Labour and Green proposals could be enacted – Moderate risk

We consider the Labour/Greens initiative to be a high impact but low likelihood risk factor for Meridian

The opposition parties have proposed creating a single entity to buy wholesale power from all of the generators, to set the price at which each generator can sell its power, and to charge for the use of water. This would have the most detrimental impact on the older, depreciated power plants such as Meridian's older hydro stations, reducing the price that Meridian can earn in the market today. This would have a profound impact on Meridian's ability to continue paying its dividend so we rate the impact as 5. However, we also consider the likelihood of occurrence in the next three years to be moderate (3); firstly, Labour/Green would need to win the next election in November 2014. Secondly, such a change to the electricity sector would require a fundamental legislative change, which would take time so would probably be scheduled for a presumed second term. Thirdly, the opposition would undoubtedly mount significant opposition, or at the very least water-down such an historic change, contributing to a longer lead-time. Therefore, while we consider the proposals would threaten Meridian's dividend, we rate the likelihood of occurrence in the next three years to be moderate.

4. Retail competition could increase – Moderate risk

The Electricity Authority (EA) launched a programme for small and medium businesses similar to its successful *'What's My Number'* programme for retail customers, and we assume this programme will also be successful. While it is difficult to predict how Meridian will fare under increased competition and customer churn, at the very least more competition will drive down retail prices for all retailers in the next three years, a moderate risk for the company.

5. A price for the use of water could be introduced – Moderate risk

Freshwater reforms are being considered, and Meridian would be affected if those reforms result in a price for the use water. We consider the impact on Meridian would be moderate and the likelihood of occurrence in the next three years to also be moderate.

6. The economy could grow at slower rate – Low risk

Meridian sells approximately half of its total volume to industrial and commercial customers, the customer classes most exposed to GDP growth rates. However, short of a major and sudden downturn in the economy on the order of what occurred during the 2007/08 GFC, we see this as a low risk over the next three years.

7. Consumption by retail customers could grow at a slower rate – Low risk

The growth rate of electricity sales to residential customers is driven in part by the population growth rate, in turn the net effect of births, deaths and immigration. While the net number of retail customers is increasing, the average annual consumption of electricity per retail customer is decreasing with the construction of new, more energy-efficient houses and the adoption of more energy-efficient appliances. As such, we do not see this as a serious near-term risk to Meridian's dividend.

8. More capital could be needed in Australia – Low risk

Meridian recently sold its share of the 420 MW Macarthur wind farm in Victoria, but continues to operate its 70MW Mt. Millar wind farm in South Australia, and says it intends to construct and operate its 131MW Mt Mercer wind farm in Victoria. The risk we considered is the potential for a large call on capital from Meridian to meet its capital expenditure programme in Australia. Meridian is forecasting approximately $400m of capital expenditure in F2014. That said, we do not consider this a major risk for four reasons. Firstly, large wind farm projects in Australia are typically financed in the project finance debt markets to a leverage ratio of 60% to 70%, so the equity requirements are for the balance of 30% to 40%. Secondly, Meridian has successfully attracted equity partners to share the risk in large projects, again reducing the size of capital calls on Meridian. Thirdly, the potential size of the capital call on Meridian ($400m) is modest relative to its overall asset size ($7.7 billion). Fourthly, Meridian has low gearing of approximately 16% so presumably has significant remaining debt capacity before its existing credit ratings come under pressure. Therefore, we rate this risk as low for Meridian.

9. Government's 51% ownership could limit future equity raisings – Low risk

Assuming the IPO is successful and fully-subscribed by investors (and we believe it will be successful), then the Treasury will end-up owning 51% of Meridian. Given that the law prohibits Treasury from reducing its position below 51%, if the company did need to raise additional equity in the future, the government would need to also invest equity in Meridian *pro rata* in order to maintain its minimum 51% interest. However, it may be politically-difficult in the future for tax payers to invest in the company, which in turn could limit any equity raisings for Meridian. However, we consider this a low risk because Meridian's gearing is low at 16% so the company has ample debt capacity remaining to fund itself, should that become necessary.

10. The Tiwai Point smelter could close – Low risk

The possible closing of the Tiwai Point smelter has grabbed the headlines, but we do not consider it a major risk to Meridian's dividend

There has been extensive debate about the potential risk to the gentailers of the Tiwai Point smelter closing. However, we consider the impact of this risk could be moderate but the likelihood of it occurring in the next three years is low for three reasons. Firstly, Tiwai Point contributes less than 1% to Rio Tinto's total revenue and the cost of closing the smelter would run into the hundreds of millions of dollars so the option to close is certainly not a free option for Rio and Sumitomo. Secondly, Meridian and Rio have agreed to a new agreement, and while many details are not public, we think that fact alone reduces the risk of an early closure. Thirdly, even if the smelter were to close, while it would likely result in low wholesale power prices for all generators in the short term, the combination of increasing demand, supply side responses (notably Genesis accelerating the closure of more units at Huntly), and the transmission system being upgraded to bring power from Manapouri station to the load centers in the North Island would rebalance the market within a few years, meaning Meridian would not have a stranded asset unable to sell its output into the power pool. Therefore, we consider a Tiwai Point closure to be a low risk event to Meridian's dividend over the next three years.

Valuation

We first undertook a discounted cash flow (DCF) analysis using our forecast for the company (see Table 3 below) to arrive at a valuation of $1.93 per share.

We then compared three forecast financial ratios for Meridian to consensus ratios for its peer group (Contact Energy, Mighty River Power and TrustPower). The three financial ratios are Dividend Yield, EV/EBITDA, P/E across two years, FY2014 and FY2015 (see Table 5).

We then took the average of the implied Meridian prices in Table 5 to arrive at an average valuation of $1.68.

Finally, we took the average value derived from the peer group comparison ($1.68) and that from our DCF analysis ($1.93) to arrive a mixed-method valuation of $1.81 per share.

For our discounted cash flow (DCF) analysis, we used the following assumptions:

Table 3 - DCF valuation of Meridian – Base Case

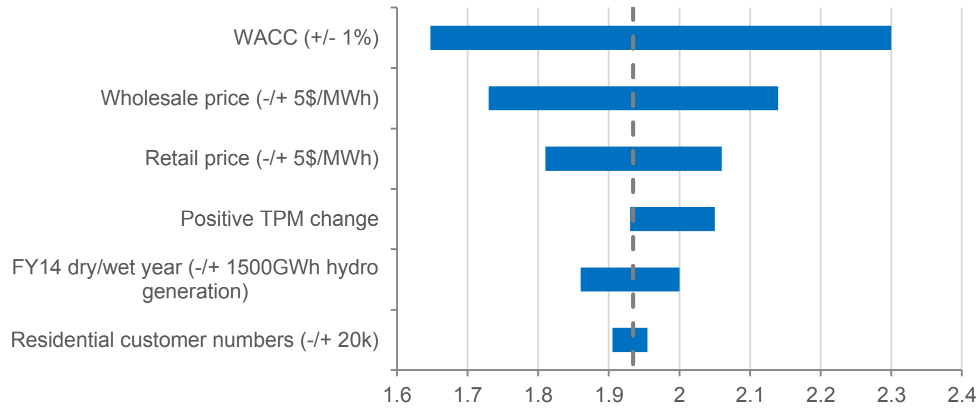
Valuation			
PV of the free cash flows in the forecast period	$m	1,559	
PV of the terminal value	$m	4,197	72% of the Enterprise Value
Enterprise Value	$m	**5,756**	
Plus cash	$m	383	
Less debt	$m	(1,180)	
Equity value	$m	4,958	
Diluted shares outstanding	m	2,563	
Equity value per share	$	1.93	

Table 4 - DCF assumptions

Assumptions		
Corporate tax rate	28.0%	
Risk free rate	4.32%	5 year government bond yield
Asset beta	0.80	
Equity beta	0.94	
Post-tax market risk premium	7.5%	
Cost of debt	7.0%	
Cost of equity	10.1%	
WACC	9.5%	
Terminal growth rate	2.3%	Nominal

We also tested our $1.93 DCF valuation's sensitivity to varying assumptions. Our analysis showed that the valuation is most sensitive to changes in the weighted average cost of capital (WACC), as is often the case with DCF analyses. The DCF is also sensitive to the wholesale price path and the retail price assumptions.

Figure 2 - DCF valuation's sensitivity to key assumptions ($/share)



Source: Woodward Partners

Table 5 compares our forecast for Meridian to the consensus forecast of its peer group of Contact Energy, Mighty River Power and TrustPower using three financial ratios, Dividend Yield, EV/EBITDA, P/E across two years, FY2014 and FY2015).

Table 5 – Meridian Valuations Implied by Peer Group

		FY14F	FY15F
Dividend yield	Contact	5.2%	5.6%
	Mighty River Power	5.8%	5.9%
	TrustPower	5.7%	6.0%
	Average	5.6%	5.8%
	Implied Meridian price	**$1.98**	**$1.90**
EV/EBITDA	Contact	8.9	8.2
	Mighty River Power	8.4	8.3
	TrustPower	10.5	9.2
	Average	9.3	8.6
	Implied Meridian price	**$1.72**	**$1.71**
P/E	Contact	18.7	16.9
	Mighty River Power	19.0	18.7
	TrustPower	17.8	15.6
	Average	18.5	17.1
	Implied Meridian price	**$1.36**	**$1.40**
AVERAGE IMPLIED PRICE		**$1.68**	

Table 6 compares Meridian's forecast dividend and implied dividend yield to those of Contact Energy, Mighty River Power and TrustPower, plus Infratil, Chorus and Telecom. We valued Meridian at $1.93 and forecast the company will pay a cash dividend of $0.11 in FY2014, producing a yield of 5.6%, broadly in line with Contact Energy (5.2% in FY2014), TrustPower (5.7%), and Mighty River Power (5.8%). However, if the final price paid for Meridian by retail investors is the price cap of $1.60, Meridian would have a competitive yield of 6.5% in FY2014 making Meridian an attractive investment proposition relative to its peers for those investors happy to hold their Meridian Instalment Receipts until May 2015.

Table 6 – Comparison of cash dividend yields

Name	Share price	FY12A	FY13A	FY14F	FY15F	FY16F
Meridian (1)	**$1.60**	**n/a**	**n/a**	**6.5%**	**7.2%**	**7.8%**
Meridian (2)	**$1.81**	**n/a**	**n/a**	**5.6%**	**6.4%**	**7.0%**
Mighty River Power	$2.27	n/a	3.2%	5.8%	5.9%	6.2%
Contact	$5.41	4.3%	4.9%	5.2%	5.6%	6.0%
TrustPower	$7.04	5.5%	5.2%	5.7%	6.0%	6.3%
Infratil	$2.48	4.2%	3.4%	4.2%	4.8%	5.5%
Chorus	$2.70	4.6%	10.7%	9.6%	8.6%	8.5%
Telecom	$2.33	8.4%	7.1%	6.9%	6.9%	7.1%

Source: Bloomberg, Woodward Partners estimates for Meridian. Values as at 30th September close.

1 – For retail shareholders who pay $1.00 at the IPO, hold their Meridian shares until May 2015, and we assume pay a second instalment of $0.60.

2 – Assuming $1.81 per share valuation derived from the DCF

We used cash dividends in Table 6 to compare them to the consensus cash dividends available on Bloomberg. However, many retail shareholders in New Zealand will be able to take advantage of the imputation credits that accompany each dividend, having the net effect of reducing their personal tax bills by the amount of imputation credits.

Table 7 – Companies Comparable to Meridian Energy

		MRP	Genesis	Contact	Trustpower	AGL	Origin Energy	*Meridian*
Ticker		MRP	n/a	CEN	TPW	AGK	ORG	***MEL***
Year end		June	June	Jun	March	June	June	***June***
Domiciled		NZ	NZ	NZ	NZ	AU	AU	***NZ***
Currency		NZD	NZD	NZD	NZD	AUD	AUD	***NZD***
Share price	$	2.27	n/a	5.41	7.04	15.42	14.1	***1.81***
Market Cap	$m	3,178	n/a	3,967	2,209	8,610	15,527	***4,639***
EV		4,225	n/a	5,257	3,120	11,438	23,842	***5,436***
Revenue								
FY13	$m	1,351	2,070	2,504	797	9,715	14,619	***2,711***
FY14		1,550	n/a	2,502	805	10,184	14,896	***2,440***
FY15		1,585	n/a	2,596	879	10,357	15,199	***2,559***
EBITDA								
FY13	$m	368	366	591	296	961	1,785	***679***
FY14		500	n/a	584	297	1,413	2,301	***561***
FY15		505	n/a	629	340	1,489	2,565	***604***
EBIT								
FY13	$m	218	225	396	230	674	1,090	***459***
FY14		338	n/a	379	229	1,119	1,541	***339***
FY15		334	n/a	414	267	1,183	1,781	***371***
EV/Market cap	%	133%	n/a	133%	141%	133%	154%	117%
EV/Revenue								
FY13	$m	3.1	n/a	2.0	4.2	1.1	1.5	***2.0***
FY14		2.7	n/a	2.1	3.9	1.1	1.6	***2.2***
FY15		2.7	n/a	2.0	3.5	1.1	1.6	***2.1***
EV/EBITDA								
FY13	$m	11.3	n/a	8.5	11.3	11.3	12.4	***8.0***
FY14		8.5	n/a	9.0	10.5	8.1	10.4	***9.7***
FY15		8.4	n/a	8.4	9.2	7.7	9.3	***9.0***
EV/EBIT								
FY13	$m	19.0	n/a	12.7	14.5	16.1	20.3	***11.8***
FY14		12.6	n/a	14.1	14.6	10.2	16.5	***16.0***
FY15		12.6	n/a	12.9	12.0	9.5	15.0	***14.6***
P/E								
FY13	X	27.1	n/a	18.8	19.6	20.5	36.3	***15.7***
FY14		19.1	n/a	19.0	17.8	13.4	19.6	***24.7***
FY15		18.8	n/a	17.3	15.6	12.5	16.8	***22.0***
EBIT/Interest	x	3.6	2.8	5.8	3.6	3.5	2.3	***4.0***
Debt/Debt plus Equity	%	25.0	34.5	27.9	38.4	29.8	32.5	***20.1***
Dividend yield								
FY13	%	3.2	n/a	4.9	5.2	4.4	4.0	***n/a***
FY14		5.8	n/a	5.2	5.7	4.3	3.5	***5.6***
FY15		5.9	n/a	5.6	6.0	4.5	3.6	***6.4***
Asset beta	-	1.3	n/a	0.80	0.37	0.53	0.98	***0.80***

Source: Bloomberg, Woodward Partners and the Meridian prospectus for Meridian. Values as at 30th September close.

How the Instalment Receipts Work

The Crown will remain the controlling shareholder

The Crown hopes to sell up to 49% of the Meridian shares outstanding, meaning it will be the majority (51%) shareholder after the IPO.

Investors will pay for their Meridian shares in two instalments

Investors who take up the offer will pay for them in two instalments. The first instalment of $1.00 per share will be payable at the IPO, and the second instalment of $0.50 to $0.80 will be payable on 15 May 2015, reducing the cash needed up-front to invest in Meridian.

Retail investors must hold their Instalment Receipts until May 2015 to cap their price

During the period between the two instalment payments, shareholders will be issued Instalment Receipts that will be converted to shares after 15 May 2015. The Crown has said the second instalment will be between $0.50 to $0.80. There is a price cap of $1.60 per share that applies to New Zealand retail investors who invest at the IPO and hold their Instalment Receipts until 4 May 2015.

Instalment Receipts holders will receive dividends

Instalment Receipt holders will receive three dividends during the period between instalment payments.

Conclusion

We believe Meridian is fundamentally a conservative investment with the ability to pay a predictable dividend. That said, Meridian does face several risks that could impact dividends, and this report focuses on those risks. We are most concerned about dry years and increased retail competition, but less so with the Labour/Green proposal or Tiwai Point. Furthermore, the new transmission pricing anticipated in 2014 represents likely upside for Meridian. We value Meridian at $1.81, meaning the $1.60 price cap for retail investors who hold their Instalment Receipts until 4 May 2015 should be an attractive price to pay for Meridian.

Appendices

Financial year end 30 June		FY12A	FY13A	FY14F	FY15F	FY16F
Profit & Loss	($m)					
Total revenues		**2,570**	**2,711**	**2,440**	**2,559**	**2,756**
Operating EBITDAF		**476**	**585**	**548**	**590**	**671**
Other income		-	-	-	-	-
Depreciation & amortisation		(225)	(220)	(230)	(271)	(213)
Change in fair value of financial instruments		53	94	13	14	-
EBIT		**305**	**459**	**339**	**371**	**458**
Interest income		8	2	-	-	6
Interest expense		(90)	(115)	(83)	(80)	(83)
Pre-tax profit (NPBT)		**222**	**345**	**257**	**291**	**382**
Tax provision		(83)	(132)	(73)	(82)	(107)
Equity accounted earnings		(3)	-	-	-	-
Abnormal items & one offs		(62)	82	-	-	-
Reported after-tax profit (NPAT)		**75**	**295**	**188**	**211**	**275**
Adjusted EBITDA		476	585	548	590	671
Adjusted after-tax profit (ANPAT)		**119**	**236**	**188**	**211**	**275**
Cash Flow	($m)					
Operating EBITDA		**476**	**585**	**548**	**590**	**671**
Working capital changes		(21)	50	(47)	17	43
Net interest & tax paid		(144)	(162)	(191)	(165)	(183)
Other cash flows from operations		10	(57)	28	(13)	-
Cash flows from operations		**322**	**417**	**339**	**429**	**531**
Capital expenditure		(520)	(251)	(402)	(138)	(75)
Free cashflows		**(198)**	**166**	**(64)**	**291**	**456**
Acquisitions & divestments		4	139	-	-	-
Associates and investments		(8)	(26)	-	-	-
Cash flows from investing		**(5)**	**113**	**-**	**-**	**-**
Debt drawn-down/(repaid)		190	(2)	14	(12)	-
Dividends		(141)	(100)	(260)	(279)	(320)
Equity issued/(bought-back)		-	-	-	-	-
Other cash flows from financing		-	-	-	-	-
Cash flows from financing		**49**	**(101)**	**(246)**	**(291)**	**(320)**
Net change in cash		**(154)**	**177**	**(309)**	**-**	**136**
Exchange rate movement		-	(9)	-	-	-
Opening cash		368	214	383	73	73
Closing cash		**214**	**383**	**73**	**73**	**209**
Balance Sheet	($m)					
Cash & cash equivalents		214	383	73	73	210
Accounts receivable		298	262	266	266	272
Inventories		5	4	4	4	5
Other current assets		54	117	99	96	96
Fixed assets		7,964	6,769	6,954	6,865	6,735
Intangible assets		27	55	47	40	33
Associates and joint ventures		4	-	-	-	-
Other non-current assets		128	148	121	162	162
Total assets		**8,693**	**7,737**	**7,565**	**7,506**	**7,512**
Short-term debt		-	-	-	-	-
Accounts payable		286	275	259	269	319
Other current liabilities		307	246	187	225	225
Term interest-bearing debt		1,826	1,180	1,194	1,182	1,182
Other liabilities & provisions		1,448	1,349	1,319	1,301	1,301
Total liabilities		**3,867**	**3,049**	**2,959**	**2,976**	**3,027**
Book value of equity		**4,826**	**4,688**	**4,606**	**4,530**	**4,485**

Financial year end 30 June		FY12A	FY13A	FY14F	FY15F	FY16F
Valuation Ratios						
EV/EBITDA	(x)	12.8	10.2	10.5	10.0	8.7
EV/EBIT		20.0	13.0	17.0	15.9	12.7
P/E adjusted	(%)	41.8	21.0	26.4	23.5	18.0
Cash dividend yield @ $1.60		n/a	n/a	6.5	7.2	7.8
Cash dividend yield @ $1.93		n/a	n/a	5.4	5.9	6.5
Imputation credits		n/a	n/a	72.0	73.0	70.0
Per share data						
EPS reported	($)	2.90	11.50	7.33	8.23	2.90
EPS fully diluted		2.91	11.50	7.33	8.23	2.90
Dividend per share		2.80	9.80	10.50	11.50	2.80
Key Ratios						
Revenue growth rate	(%)	5.5	(10.0)	4.9	7.7	3.2
Operating EBITDA growth rate adjusted		(4.8)	28.1	(17.3)	7.6	11.0
Operating EBITDA margin adjusted		20.6	25.0	23.0	23.6	24.3
Tax provision rate		52.8	30.9	28.0	28.0	28.0
Dividend payout ratio		60.6	106.5	143.1	139.5	116.4
ROE adjusted		1.5	6.2	4.0	4.6	6.1
Net debt to book value total capital (D/D+E)		25.0	14.5	19.6	19.7	17.8
Net debt to EBITDA	(x)	3.0	1.2	2.0	1.8	1.4
Net debt to EBITDAF		3.4	1.4	2.0	1.9	1.4

Stock Recommendation Criteria

Buy	Expected to outperform the NZ market by 15% or more over next 12 months
Accumulate	Expected to outperform the NZ market by 5.0% to 14.9% over next 12 months
Neutral	Expected to perform plus or minus 4.9% with the NZ market over next 12 months
Reduce	Expected to underperform the NZ market by 5.0% to 14.9% over the next 12 months
Sell	Expected to underperform the NZ market by 15% or more over the next 12 months

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