

## MEUG update of Economic Profit of Contact Energy Ltd based on the year-ended 30 June 2022 financial results. Published 11 October 2022

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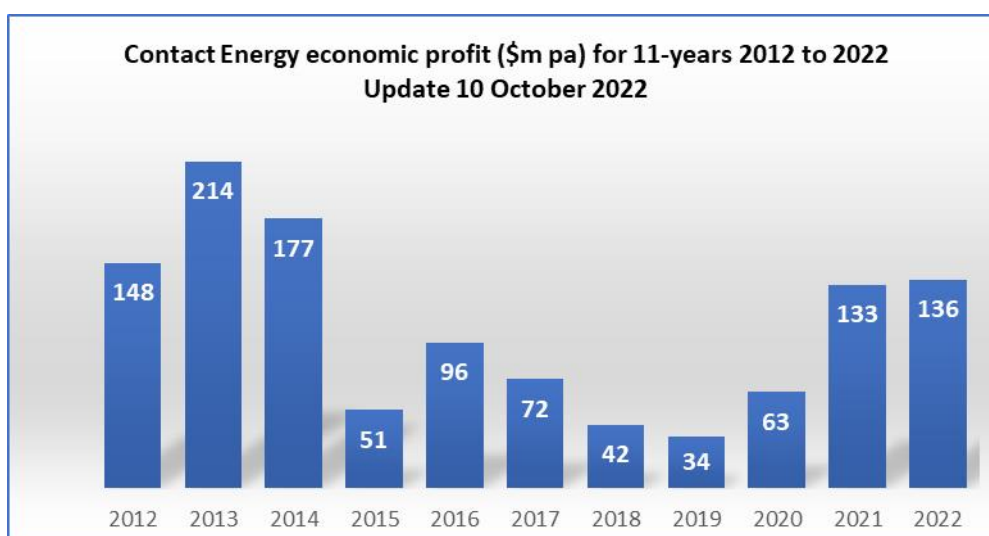
### Purpose and background

1. This is the second update of the Economic Profit Analysis (EPA, also referred to as Economic Value Added (EVA) analysis) trends for Contact Energy Ltd (CEN) by adding the financial results (published 15 August) to the existing 10-year analysis (adjusted for revaluations since 1999).
2. An inaugural pilot EVA for 2020 for Meridian Energy Ltd (MEL) was published in August 2021. The pilot study was extended to CEN, with results for 2021 published January 2022. These pilot studies confirmed EVA was feasible. Key background documents are:
  - ~ MEUG Q&A on EPA methodology and results for MEL, 14 August 2021, <http://www.meug.co.nz/node/1150>.
  - ~ Pilot EPA of CEN, 28 January 2022, <http://www.meug.co.nz/node/1182>. Selected analysis details in spreadsheet and .pdf format were also published.
3. A separate EVA 2022 update for MEL has been published today.
4. The last section of this memo has a recap of terms used and relevance to interpreting EVA trends.

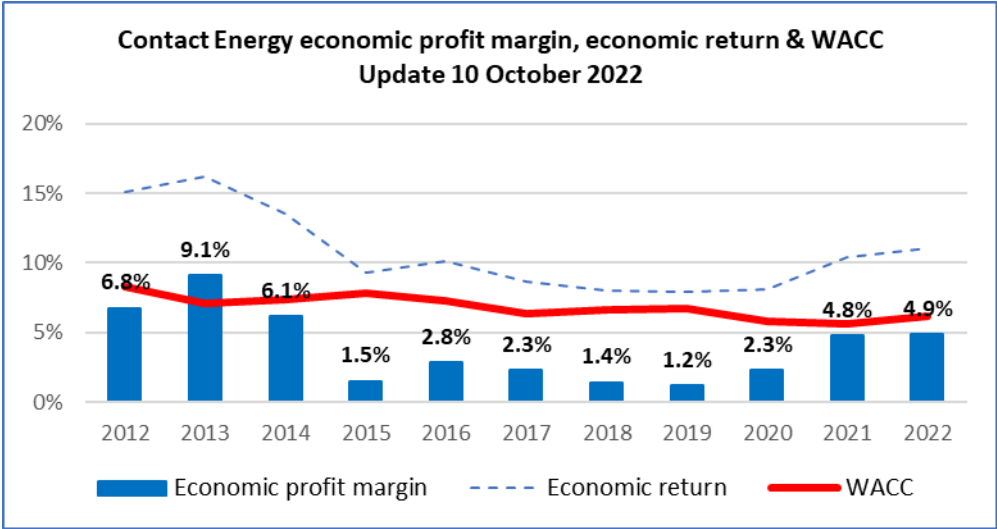
### Key results of the EVA 2022 update for CEN

| June year end          | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  |
|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| NOPAT (\$m)            | 329   | 381   | 390   | 319   | 342   | 273   | 236   | 221   | 225   | 289   | 310   |
| Average capital (\$m)  | 2,182 | 2,347 | 2,878 | 3,424 | 3,380 | 3,154 | 2,942 | 2,800 | 2,787 | 2,774 | 2,800 |
| NOPAT/Average capital  | 15.1% | 16.2% | 13.5% | 9.3%  | 10.1% | 8.7%  | 8.0%  | 7.9%  | 8.1%  | 10.4% | 11.1% |
| WACC                   | 8.3%  | 7.1%  | 7.4%  | 7.8%  | 7.3%  | 6.4%  | 6.6%  | 6.7%  | 5.8%  | 5.6%  | 6.2%  |
| Economic profit margin | 6.8%  | 9.1%  | 6.1%  | 1.5%  | 2.8%  | 2.3%  | 1.4%  | 1.2%  | 2.3%  | 4.8%  | 4.9%  |
| EVA (\$m)              | 148   | 214   | 177   | 51    | 96    | 72    | 42    | 34    | 63    | 133   | 136   |

5. The chart below illustrates economic profit trends over the last 11-years.



6. The following shows trends in economic return, WACC and economic profit margin. Economic profit margin equals economic return less WACC.



**Commentary**

- 7. Since 2015 the trend has been relatively steady state.
- 8. For the 2021 reports we found CEN financial results were easier to adapt to the EVA framework than for MEL. That proved to be the same this year with the bulk of the EVA 2022 update for CEN completed within 3-weeks of the financial results being published.
- 9. Depending on feedback on this update, next steps may include:
  - ~ Briefing and answering questions from policy makers.
  - ~ Discussing with CEN. This could include comparing this EVA update with the analysis of Return on Invested Capital in CEN’s financial results.<sup>1</sup>
  - ~ Consolidating the CEN and MEL EVA updates. The 2022 updates use the same model and adjustments to facilitate consolidation. Ideally in future years EVA for Mercury Energy and Genesis Energy would provide an overview of the whole sector. In the meantime, a partial view of the EVA for two large suppliers may provide useful policy insights.

**A recap of terms used and relevance to observing EVA trends**

- 10. EVA is the Net Operating Profit after Tax (NOPAT) measured against the economic capital charge. NOPAT is calculated using data from audited financial statements and then adjusted to better reflect “cash returns” on “cash invested” year by year. The economic charge is the Weighted Average Cost of Capital (WACC) times average capital invested.
- 11. In competitive markets individual companies and the industry in some years will have a positive EVA (earn economic profits), other years a negative EVA (incur economic losses). Over a long period of time cumulative EVA for the industry should trend to zero, whereas individual company EVA can be more volatile and not correlated with average industry trends.

<sup>1</sup> Refer CEN Investor Presentation 15 August 2022, slides 25 and 39, <http://nzx-prod-s7fsd7f98s.s3-website-ap-southeast-2.amazonaws.com/attachments/CEN/396941/376502.pdf>