

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

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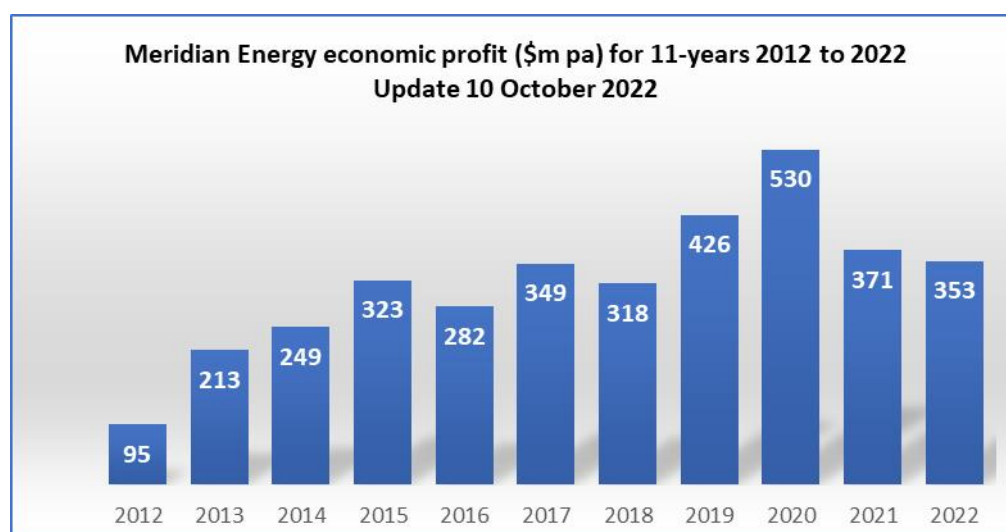
Purpose and background

1. This is the third update of the Economic Profit Analysis (EPA, also referred to as Economic Value Added (EVA) analysis) trends for Meridian Energy Ltd (MEL) by adding the 2022 financial results (published 24 August) to the existing 20-year analysis.
2. An inaugural pilot EVA for 2020 for MEL was published August 2021. An update for 2021 was published September 2021. The pilot was extended to include Contact Energy Ltd (CEN) for 2021. These pilot studies confirmed EVA was feasible. Key background documents are:
 - ~ MEUG Q&A on EPA methodology and results for MEL, 14 August 2021, (2020 June year) <http://www.meug.co.nz/node/1150>.
 - ~ MEL EPA update, 20 September 2021 (2021 June year), <http://www.meug.co.nz/node/1157>. Selected analysis details in spreadsheet and .pdf format also published.
3. A separate EVA 2022 update for CEN has been published today.
4. The last section of this memo has a recap of terms used and relevance to interpreting EVA trends.

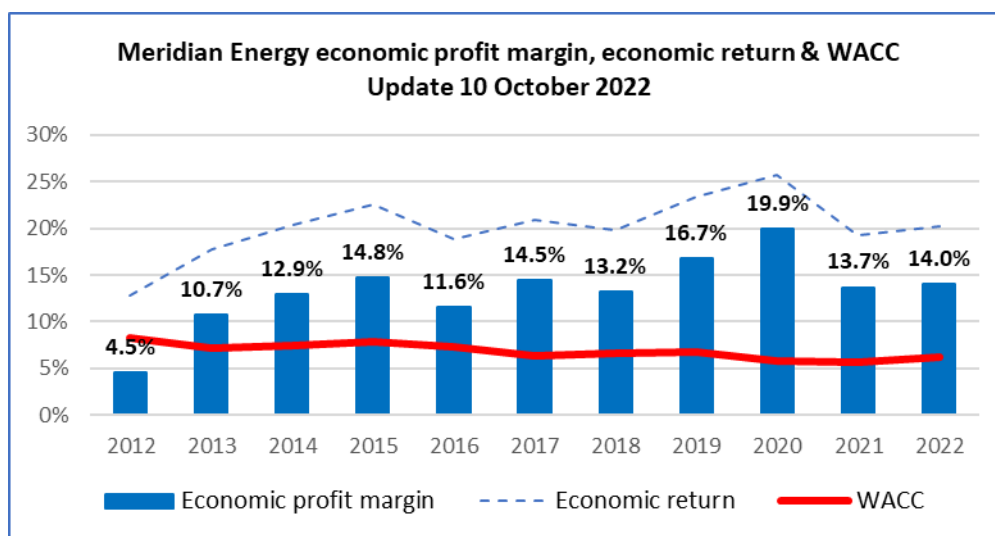
Key results of the EVA 2022 update for MEL

June year end	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
NOPAT (\$m)	269	354	391	493	460	504	478	597	684	523	510
Average capital (\$m)	2,097	1,994	1,928	2,186	2,439	2,417	2,412	2,546	2,664	2,711	2,523
NOPAT/Average capital	12.8%	17.8%	20.3%	22.6%	18.9%	20.9%	19.8%	23.4%	25.7%	19.3%	20.2%
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	4.5%	10.7%	12.9%	14.8%	11.6%	14.5%	13.2%	16.7%	19.9%	13.7%	14.0%
EVA (\$m)	95	213	249	323	282	349	318	426	530	371	353

5. The chart below illustrates economic profit trends over the last 11-years. This is a snapshot to parallel the 11-years of the CEN analysis. The MEL analysis, per prior years, starts from 1999.



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



Commentary

7. The high economic profit trend relative to WACC continued into 2022. The EVA for 2022 of \$353m is about \$1m per day economic profit for MEL.
8. As we have found in prior years the MEL financial results are complex and time consuming to convert into an EVA framework.
9. Depending on feedback on this update, next steps may include:
 - ~ Briefing and answering questions from policy makers. Our focus will be on ensuring there is clarity on revaluation, and related depreciation and equity effects, as those are the key differences between MEL and CEN when calculating economic profit.
 - ~ Discussing with MEL. This could include comparing this EVA update with the PwC report to MEL, “Meridian Energy Limited – Economic profit calculations, September 2021”.¹
 - ~ 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.

¹ Refer <https://meridian-production-media.s3.ap-southeast-2.amazonaws.com/public/210929-Meridian-Summary-of-Economic-Profit-calculations.pdf>