

Accelerating super profits raise stakes for a comprehensive review of wholesale electricity market

Meridian generates \$3.5bn excess economic profits over the last 20-years, 56% of these since 2016

(Wellington, 24 August 2021) - In response to unsustainably high and volatile wholesale electricity prices the Major Electricity Users' Group ('MEUG') has today released the findings of an *Economic Profitability Analysis* of Meridian Energy's last 20 financial years, which show that 56% or \$1.96bn of the total identified \$3.5bn excessive economic profits generated have been delivered in the last five financial years, 28% in the last two years.

The EPA analysis, undertaken by independent financial advisory firm [Ireland Wallace & Associates](#) is intended to add substantive information directly relevant to assessing whether New Zealand's wholesale electricity market is working in the long-term interests of consumers, and the country.

John Harbord, Chairman of the Major Electricity Users Group says: "This analysis indicates persistent super profits being generated by one of the large generators. These findings support undertaking further analysis of the other gentailers to create a complete picture of what's happening across the sector, which would assist the Electricity Authority in conducting a comprehensive review of market forces and operating rules currently governing New Zealand's wholesale electricity market.

"There are market complexities at play that are giving rise to levels of profitability that significantly outperform the Commerce Commission's criteria for 'persistent excess profit'. This raises some complex questions relating to largely unexplained pricing events, which we believe the regulator needs to work through and answer with the sector, households, SME's and major electricity users.

"At stake is the future of New Zealand's industrial manufacturing and processing base which represents some of the most emissions efficient in the world, including many of the highly skilled jobs which underpin regional economies throughout New Zealand.

"New Zealand's economic future also looks very different now to when the wholesale electricity market was first established back in the 1990s. It is clearly time to take a step-back and check that the design features of the market remain fit for this future – to ensure efficient adoption of cost-effective new technologies and support a just transition to meet our net zero obligations. This needs to be prioritised and done urgently," says Mr Harbord.

Summary of Findings

- The purpose of analysing Meridian Energy's economic profitability between 2002 and 2020 was to test if the methodology was feasible and scalable to the industry and to shed light on trends in economic profitability, including to support the early work underway by the Electricity Authority into the current state of the wholesale market.
- MEUG notes that the profits being generated by the country's largest electricity provider are not reflective of the sector as a whole but is sufficiently confident that the analysis undertaken represents a robust and compelling reference for the regulator.
- Work commenced early 2020 to prove the feasibility of the methodology and since April 2021, we have applied it first to Meridian Energy.
 - *The results show a 20-year cumulative excess economic profits for June years ending 2002 to 2020 of ~\$3.5b.*

- For the last 8-years between 2013 and 2020, excess economic profits ranged from \$237m and \$560m per annum.
- For the last 5-years, 2016 to 2020, cumulative excess profits were ~\$1.9b (just over half of the cumulative 20- year excess profits).
- In the last 2-years the excess economic profits have been the highest observed over the last 20-years. In particular, the excess economic profits for June years ending 2019 and 2020 were \$438 million and \$560 million respectively.

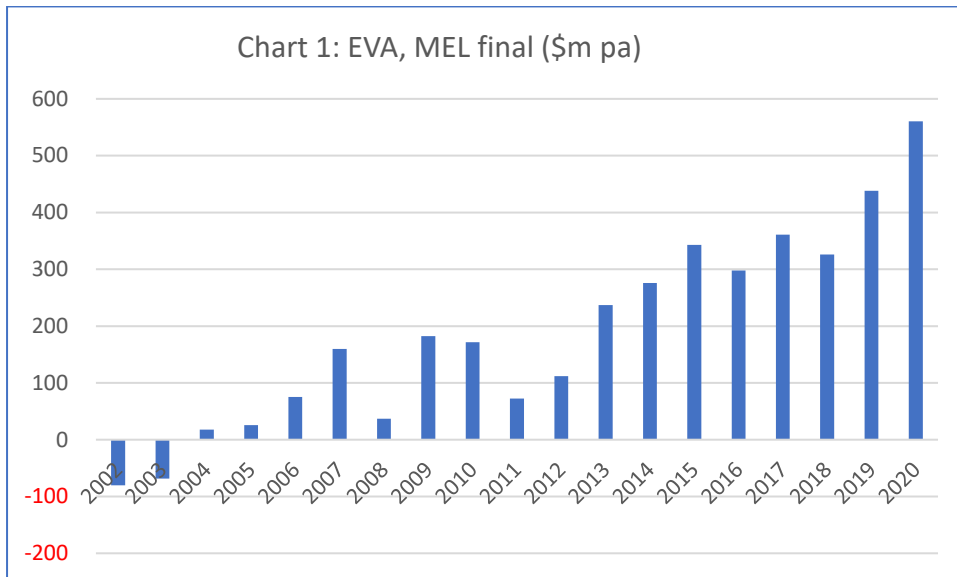


Chart 1: the dollar value of the Economic Value Added (EVA), that is the value in excess of a capital charge (equivalent to the excess economic profit) over time for Meridian Energy - analysis dated 28th July 2021.

Mr Harbord adds: “Based on these rising levels of profitability Meridian has outperformed the level of profit-making seen in the Commerce Commission’s retail fuel market and ongoing supermarket studies. The Commerce Commission deems the weighted average cost of capital (WACC) an acceptable benchmark to assess a level of profit for regulated companies possessing market power. “In the last five years, Meridian has averaged profit 250% above its estimated WACC – in FY 2020 Meridian’s profit was 300% above its estimated WACC. The retail fuel market saw volatility in excessive profits, but for Meridian there has been no volatility in the last seven years – the increased profits have been largely constant year-on-year since 2014.”

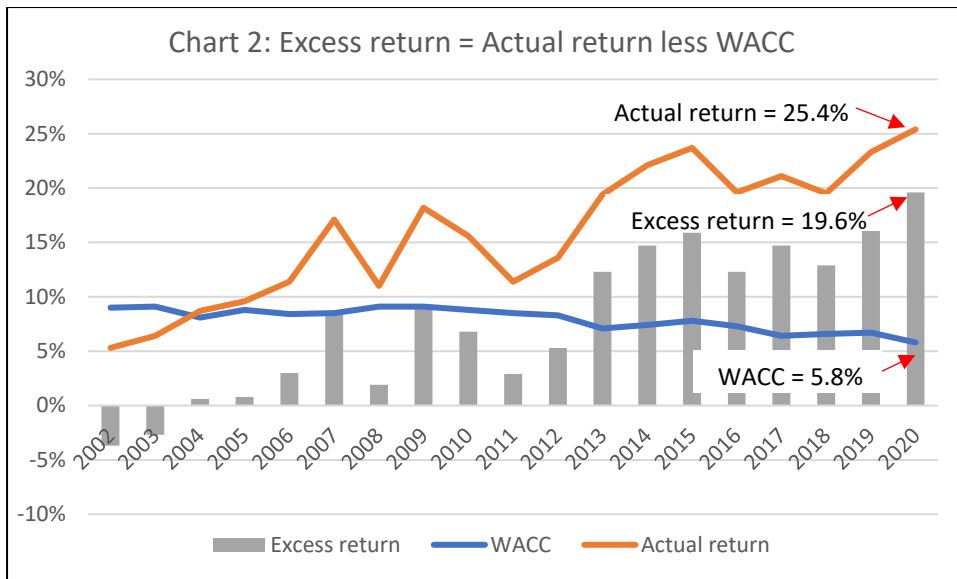


Chart 2: the economic profit (labelled “actual return”), WACC and the difference between the two being the excess return (or excess economic profit) in percentage terms - analysis dated 28th July 2021.

Unexplained Price Movements

Mr Harbord notes that there are also movements related to how the marginal price of generation is setting the price, which remain unexplained.

“We are seeing events where wholesale prices do not follow hydrology. We have had high wholesale prices for three years. All of those years have not been dry years. In June and July this year it rained in the hydro catchments and the price went down as you’d expect. In May it rained in the hydro catchments and the price went up.

“Gas shortages are contributing to high wholesale prices, but gas and coal has over the first quarter of this year directly set the marginal price of generation only 15% of the time.

“We expect prices to remain volatile and unexplained material events need to be a focus of comprehensive review of the market rules to encourage certainty and confidence in the system going forward,” adds Mr Harbord.

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For further information, please contact:

John Harbord
 Chairman
 Major Electricity Users Group
 027 683 8983

Or

Hugo Shanahan
 0275 111 561
hugo@shanahan.co.nz