Meridian Energy Investor Briefing 10 July 2020 – Live Transcript

>> OWEN: Good morning, everyone, Owen Hackston speaking, Meridian's Investor Relations Manager. Joining me is Meridian Chief Executive Neal Barclay and Chief Financial Officer Mike Roan. We'll work through the brief pack that was attached to our market release this morning. Then we'll move to question time. When we get to that point, can you please follow the instructions of the call moderator who will talk you through how to create a call. I'll pass over to Neal.

>> NEAL BARCLAY: Good morning Everyone. I'm sure you've all caught up with the news. We do have a pack, we'll try add colour and a bit more of the backstory when we go through it. As you're aware, Rio Tinto is terminating the contract as of the end of August 2021. In terms of when Meridian found out about this, it was exactly the same time as everybody else. I heard on the phone and, pretty well, at the same time our comms people were receiving the notification, so we were as informed as the rest of the market. We do expect they will wind-down operations over that time. You will need to recall that Meridian's contract with the smelter is a financial contract. So it is possible that the financial volumes will stay in place until the end of August 2021 but the physical volumes will start to drop off as they close pots and potlines, etc. We've had no real engagement with them as to how they operationally plan to do that, but we expect to have that in the next few days, because I do understand they've got a plan.

Our current contract and pricing stays in place for the next 14 months. The pricing around that contract is confidential. But what we have decided to do is to give you a bit more of the context in terms of the package that we had on the table with the smelter. I've given you some context in the past that what we were seeking was a stronger commitment to term. The most recent deal was a four-year commitment to term, with reduced rates, it had some demand response premium associated with some demand response that we felt was in both parties' interests. Recently, the industry came together and we were able to add in a transmission underwrite.

The total value of the package was $50 million from the get-go, and increasing to close to $60 million, $70 million over the next three years. We understand it net the US dollar energy-delivered cost target that they talked to us about mid-last year. We understand it got the smelter to the midpoint globally. So from our perspective, it still looked like a compelling smelter going forward.

Additionally, as recently as Tuesday, I was talking to the Managing Director of Pacific Operations and reiterating our message we had given them some time ago, that we could actually do better than that if there was a stronger commitment to New Zealand. What we were talking about there was a commitment for the full 10 years of the contract. If Rio Tinto had been willing to stump up for that, then we could have got them a long way, we think, towards their ask of a third off, which was introduced to us last December.

So from our perspective, we've been seriously negotiating with this organisation for quite some time. We've been doing it in good faith. We haven't been tinkering around the edges. We've actually made a meaningful offer. Others have come to the party as well. Most obviously Contact, but certainly, Mercury and Genesis were there when we started talking about the transmission underwrite idea. We think we've put a pretty compelling proposition to them but they've decided it is not good enough.

Clearly, from our perspective, it looks like there's bigger issues at play in regard to the overall Rio Tinto portfolio. Very unfortunate, but it is what it is. If we move to what that means for us, on page 3 of the Investor Presentation we've got a bit of a business update. Then I'll hand over to Mike.

First off, we've confirmed with our board that there'll be no change to Meridian's current ordinary dividend policy. So 75 – 90% free cash flows. Analysts are predicting a pretty healthy result for this financial year which we align with. So I think the ordinary dividend will be a strong one. But also, with immediate effect, we will end the capital management programme. The reason for this is the board are cautious, given that' 2022 and 2023 will be challenging years financially given the transmission work that still needs to take place to free up Manapouri and Clutha schemes. And we are also mindful of retaining our BBB+ credit rating. So the board are taking a cautious approach and we think it's the most prudent thing to end that capital management programme. To be really clear, the last payment under that programme occurred in February of this year.

I'll hand over to Mike to talk through some of the other mitigations we're working on.

>> MIKE: Thanks, Neal. The first one we've tabled here is the swaption process that we've been running for 2023. Probably won't be a surprise to people but we will discontinue or abandon that process. That said, we will probably still look for products that help us manage peak North Island risk but certainly our exposure to dry years or hydrology dissipates as the smelter load disappears. So that process isn't one we need to continue.

The current swaption process we have rights to terminate that, which we intend to do. In saying that, we will have a conversation with Genesis to see whether there are a wider set of choices that might make sense for their portfolio and for ours moving forward.

In terms of the portfolio response more generally, it won't come as a surprise to anybody that we've developed a series of mitigants over the past few years, as this issue has been in gestation for a long, long time. I'm going to talk about the Clutha-Upper Waitaki Lines project soon and transmission more generally, but the first one people may or may not remember are the changes that we made to the operability in Lake Pukaki. Last November we let the market know that the low range of that lake was now available for operational use and that creates and provides us increased flexibility to manage hydro storage across our catchments and in the short-term helps us manage any constraints between Southland and Canterbury and then, over time, help us manage energy flows between the South and North Island.

A reasonable amount of GWH in there. That frees up an additional 367 gigawatts hours of storage in Lake Pukaki and combined with the earlier work that we did to access that range from 513 to 518m it created an additional 545GWH of storage or about 25% of storage, which gives us increased flexibility given the circumstances we find ourselves in.

Of course, with the change that's been announced we will talk to wholesale competitors about bilateral contracts that make sense for them and for us. Again, we've had any number of conversations over the years with some parties in that regard. Portfolios are expected to change following the announcement as people rebalance and, most likely, thermal plant retires.

So we don't have an update for you today on what that looks like, but we will do so as we make progress there. Just to note that we took some insurance earlier this year. We did put some sales on ASX at Benmore through 2023, really to stabilise our cash flows. Obviously we didn't have any information as to what Rio Tinto would do at the time, but we thought it was prudent, as we have always thought the risk of either Rio staying or going was reasonably balanced.

I'm going to talk to this next bullet in a sec, but once we've dealt with the or Transpower's dealt with the constraint between Southland and Canterbury, the challenge is the HVDC link. When we look at that facility, we really see the constraint being the north Island reserve market, as opposed to transmission capacity on the link. We have done some work ourselves on activities or options that would allow us to better manage the flows of energy across that link and participate in that North Island reserves market, hence the reference to a North Island battery solution, which would allow us to do that.

Last bullet, probably self-evident, this frees up a reasonable amount of energy for us and, you know, our retail team, our customer team is looking forward to the opportunity that creates for them, and for us to grow our brand with customers throughout New Zealand. So that that will be an interesting and good challenge for us.

Last piece is really just to note we've got a wind farm up in the Hawke's Bay that's got a strong investment case. We haven't made any decision in relation to that investment and of course we'll take the events of yesterday into consideration as we think about that investment.

If i turn the page and just talk a bit about transmission. This is a summary of the work going on to free up transmission between Southland and Canterbury. Much of it will be known to you. Trans-power announced it will continue the work it started as a result of ourselves and Contact funding or pre-funding the lines work. The lines cost about $97 million, just under $100 million for Transpower to complete that work. Again, they've tabled that will be completed in June 2023. We will work with them in the meantime to mitigate the impact of line outages that may occur to facilitate that progress. But, you know, we will be encouraging them, they obviously have a material incentive now to not only build that facility as fast as they can, but also think about transmission constraints, more generally.

The key piece for us is the completion of that lines work. It facilitates the full export of generation out of Southland. You can see that captured on the graph on that page, the green-sloped line is utilisation as we currently see it with NZAS in place. The Grey line, horizontal, line shows capacity in transmission, the red line shows the increase in capacity and the blue line shows forecast utilisation without that consumption in Southland.

As I mentioned, Transpower's programme is wider than just the Clutha-Upper Waitaki line initiative. They told the market yesterday that they have a programme, cost them about $600m. In the last estimate, they said it would take five to seven years to complete. $100 million is on the Clutha-Southland Waitaki lines work. There's about $150 million we understand on the HVDC which would facilitate a fourth cable.

As I mentioned, we don't see the HVDC constraint as necessarily being that big a challenge, but we will encourage them to do that work. And the reason we see the challenges being manageable between the South and North Island is on average there about 300 megawatts currently transferred between the two islands currently. If you add 600 megawatts, given the consumption reduction in Southland, takes it to about 900 megawatts on average. With a 1,200 megawatt link, really, there is room, so long as we can manage a better solution than we have for North Island reserves where the HVDC is operationally constrained to about 950 to a thousand megawatts at any time.

A battery as we see it, that that opens up that link and helps it use its full capacity, when we've done the economics on it, it's a bit of a no-brainer from a commercial perspective and it creates additional flexibility for us. But the primary focus is to free up power transfers between the North and South island.

The remaining spend is on the central North Island constraints and then the completion of the Auckland voltage work which they've confirmed will be completed by 2022. The central north island constraints they say will take between 5 to 7 years to complete. We are on record and have said previously that the Central North Island constraints, we don't feel represents an impediment to us to do our business and the entire industry has an incentive the free those up in any event as everybody has a material amount of energy that's produced and will be sent through those lines or south of that transmission constraint.

>> NEAL BARCLAY: I'll sum up. Clearly the decision isn't the one we wanted but at least it provides clarity and we can move forward. I'm super confident and I've said there a number of times, that Meridian will be a stronger business in the medium to long-term and we can manage through this disruption over the next few years as we get transmission and other solutions in place.

As Mike's just talked about, clearly the Clutha-Upper Waitaki transmission work is the most significant first-up mitigation. It must be the number one transmission enhancement project in the country at the moment. We'll be working with Transpower to see if we can accelerate that in some way. To date, it's been an option but now it is a real, live, absolutely necessary bit of functionality for the market.

Mike has talked about a lot of the solutions to ease the constraints on the HVDC. We think it is largely a North Island reserve market issue. The market will, i believe bring options to the table.

And one last point that we haven't mentioned yet. With this exit, it will change the allocation to beneficiaries under the new TPM forecast. Energy flows will change so the BAU scope savings may be different. We don't have an idea of what that is but we're just sort of flagging it. So that's what we had prepared to say. We can hand it over to questions now.

>> ANNOUNCER: Please press 01 on your key pad and wait for name to be announced. There'll be a short delay while we collate responses. Our first comes from Andrew Harvey Green, Forsyth Barr.

>> ANDREW: A few questions, as you can probably expect. The first one is just in terms of the wholesale price outlook, obviously the ASX curve looks off at the moment. I'd be interested in your perspective of the UTS decision and presumably that will have a flow through effect to Southland prices?

>>MIKE ROAN: Thanks Andrew. I think we're still working through what kind of effects the UTS might have on the market. So probably a little early from that perspective. In terms of prices more generally, you know, you would have picked up, I'm sure others would have as well, that the ASX, there wasn't strong volumes traded yesterday and, you know, I should acknowledge that the market-makers, who typically provide liquidity, had all stepped out of that market yesterday. But ASX fell for 2022/2023 by between 20 and 25 bucks a megawatt hours on the news. That kind of price level you see was not unexpected from our perspective, but it will take a while for that market and views on price to really reform, I think, Andrew. Like all events of this magnitude, it takes a little bit of time for people to firm their views and capture information. I think as a first stanza, yesterday, was a reasonable adjustment to what was expected but time will tell.

>> ANDREW: Thanks. The second question is around bilateral discussions that you'll be kicking off. Are you able to give us any sort of idea of what you'll be looking at in those sorts of discussions

>>MIKE ROAN: I think it is really bulk energy, Andrew. Based on previous conversations, based on how we look at portfolios and setup right now, it's obviously a bulk energy transfer that we're contemplating in the coming years. The real question for us, and others, is how does that help

people shape their own portfolios, given, you know, the alternate choices that they have. Way too early to frame up what that might mean for outcomes but I do really think it's a bulk energy, kind of transfer as people adjust their underlying portfolios. They're like portfolios to be dove-tailed and transitionary alongside those other choices. I don't see them as being necessary long term arrangements but I see them as providing portfolio certainty and assurance during uncertainty at prices that are reasonable and delivery points that reflect the risks that people are taking on. Again, not as much detail as you might like but I think if you're thinking bulk energy, you're in the right space

>> ANDREW: I was definitely thinking bulk energy but that still leaves quite a wide range. In terms of these discussions, how keen from a Meridian's perspective are you to intiate those discussions or are you more - you're open to discussions for people coming to you?

>>MIKE ROAN: I think a bit of both, Andrew. We have a pretty efficient market. I think contracts help manage that uncertainty. Some of -- efficiency. Some of that is about managing security of supply as well to the extent people do make choices with their thermal facilities. I think the market is pretty good at ensuring that, you know, contracts help manage the uncertainty that's in front of people and help deal with those economic and secure supply choices or, you know, resilience.

We'll be on the phones with people. I'm sure that they'll have a good view of what that might mean. But it'll take time because gone from this being a possibility to, you know, this is the future that we now face. So I think - I don't know if I gave you a timeframe earlier as I was talking but we expect in the next four to six weeks we might have something, you know, that's a little more detailed and concrete than what I've given you today, which I'm sure you would say, isn't much more than a statement.

>> ANDREW: That's helpful, thanks. The third question is around the ordinary dividend policy and how rigidly is that actually going to be kept? Obviously with no special dividends, Meridian's very strong balance position and there's no dry year risk going forward as you said, so, you know, will Meridian really cut that ordinary dividend if fine is manageable or will you look through that FY 2022-23 year to some degree?

>> NEAL BARCLAY: I think we'll take a long-term perspective on it, Andrew, we're always looking forward three years and FY 22-23 will be the challenging years no doubt. So we will look through that but we think that policy gives us the flexibility to reward shareholders when there is strong underlying financial performance.

>> ANDREW: Second-to-last question from, around discussions you've had with Rio in the past, do you have a sense of when and how that ramped-down timeframe might look like? When it might start and what sort of stages we're looking at

>> NEAL BARCLAY: No. No, we don't. The understanding has always been that when we completed negotiations either successfully, unsuccessfully, on the continuation, we would move to a staged exit negotiation. If that was, you know, the outcome. And, certainly, when Mike and I were talking to Alf Barrios here in December last year, we got a strong sense that there was no way that they saw themselves walking away with a relatively short notice period e.g. , one year. That's totally inconsistent with the notice we got from them yesterday. I have had one verbal confirmation from our counterpart in Australia that suggests they are open to some sort of offer. But like I say, they've come out with a pretty clear and firm communication, so we've still got to work through what alternate options there are for a more orderly exit. And if there are any options.

>> ANDREW: Which dovetails into my final question. Are there any viable options other than closure that you can foresee at this point in time? Is there any viable scenarios here?

>> NEAL BARCLAY: Look, it's hard to see it. I heard it suggested yesterday that this was the next level of a negotiating tactic, but if it is, it is a pretty cynical play in terms of their own employees and the community in Southland. So I don't think that's really at play. I think they've decided they want to close the smelter. Maybe there's a possibility to extend that closure period but, like I say, that's not consistent with the communications we've seen yesterday, and we haven't really seen anything other than that.

Alternate ownership? Well, they tried to sell it back in, 12/13,' 13/14 in fact, and it didn't play out for them so, I'd say that's less likely as well. Also, I do believe this is a portfolio play from Rio and they are looking to curtail supply. As part of the overall portfolio mix. So whether the sale would be in their interests... anyway, you'd probably need to go and ask them about that.

>> ANDREW: That's great. Thanks for your time.

>> ANNOUNCER: Next question is from Grant Swanepoel

>>GRANT: Good morning, can you hear me?

>> NEAL BARCLAY: Yes, Grant.

>> GRANT: Great presentation and timely. Did I hear you indicated there's scope potentially, you're opening the door, might be scope for negotiations around a delayed exit?

>> NEAL BARCLAY: Grant, what I'm saying is the communication that we've received in the last 24 hours would suggest not, but the verbal communication or sort of understanding we had with Alf Barrios, in person, here in Wellington last December; suggested that would be their most favoured option, a more orderly exit over a number of years...

>>GRANT: It is based on older conversations, not something you've had...

>> NEAL BARCLAY: No, but again, I was talking to my counterpart in Australia yesterday morning and he indicated they'd be open to some sort of offer. But there's been radio silence since then. We really do need to hear from them directly if they were interested in some sort of...

>> GRANT Thank you. In terms of the battery solution or potential battery solution, what is that going to cost more or less, in your view, per 100MW Also, how quickly can you get that sort of response up and running? Is

>>MIKE ROAN: We might call Elon Musk, Grant, get him up pretty quick if they need to. Battery solutions, as you noted, about 100 megawatts, you can frame and stage them how you want, whether it is 100 megawatthours or less, or more, you know, you can go over a longer period of time. We think max of about $70 million, and on that basis, the energy transfers that it facilitates to the extent the North Island reserve market constrains the DC back down to that 900, 950 megawatt level we've seen historically, the economics are really straight forward.

In terms of timeframes, we're obviously thinking through how effective that solution would be alongside the build of the Clutha Upper Waitaki lines project. That line project completion facilitates the release of about a thousand gigawatt hours of energy that we've said would be spilt on average. So we've got plenty of time, is maybe the simple summary, for that battery solution to be deployed. At worst, it would need to be in place by the end of August 2021, but, again, we think we've got more time than that. Unless Transpower are able to revise their own programme and bring that

Clutha-Upper Waitaki project a lost faster than they've suggested. We'd be delighted by that and we would accept the challenge of a battery inside of period if we had to.

>> Grant: So actually it is not a critical path. It is enough time to get one in place to the North Island, so actually the transmission constraints might not be the issue it's made out to be?

>>MIKE ROAN: That's pretty much how we see it, Grant.

>> GRANT: Thanks, all.

>>MIKE & NEAL: Thanks Grant

>> ANNOUNCER: Next question is from Eric Frykberg, Radio New Zealand.

>> ERIC: Yes, hello, what would be the possibility of power no longer Tiwai going to Fonterra, given that Fonterra wants to get out of coal? But would need electricity a lot cheaper than it has now. Maybe something closer to the belt supply tarrif that you have with Tiwai. What possibility is there of some movement in that direction?

>> NEAL BARCLAY: Eric, we would hope so. We're more than happy - in fact, we have had reasonably considerable conversations with Fonterra in the past and we're more than happy to talk to them about a bulk power solution in that part of the world, or any part of the world for that matter, but certainly in Southland. We think, clearly, if they were on similar price terms to what the smelter were getting, it would be a reasonably compelling option for them. But, you know, that's really their choice. But we're here to work with them if that's what they'd like.

>> ERIC: Thank you very much.

>> ANNOUNCER: A final question from Steven Husdon, Securities.

>> STEVEN: A couple from me. Firstly, I wanted to clarify, Neal, the point you made about your Australian counterpart. Is that a reiteration of what the NZAS CEO is reported as saying yesterday, they are open to an electricity supply deal where you're referring to the top phase down?
I just wondered can you give us some idea about how the rating agencies are likely to consider this and how defendable that rating is?
Then, thirdly, you talked about some insurance you'd taken out. I wonder if you can give us some magnitude for that, the order of magnitude for that insurance?

>> NEAL BARCLAY: Yes. I will come back to that third question, I'm not quite sure I understand it. But on the first one, no, the conversation I was having with Andrew Horvat, who is the NZAS Chairman, was of the nature of making an offer potentially a phased closure of the facility. So, whatever that looks like. What Stew Hamilton, the GM of operations in New Zealand, said in the media yesterday... we still need to clarify what that means but that's not consistent with everything else we've heard. So as far as we understand, the chance - well, a deal for the ongoing operation of the smelter has passed. That opportunity has passed. We're talking now about closure arrangements.

>>MIKE ROAN: Hey, Steve, I'll pick up the second bit on credit rating. As Neal mentioned at the start of the call, the our board is committed to maintaining its current credit rating of BBB +. We've talked to S&P and they'll confirm they might come out with something this afternoon and possibly put us on Credit Watch with a negative outlook, given the events that have played out. But, you know, we will convey that to the market, if that's what we receive, and - but that's probably as much as we've got. I think the key piece is, from our perspective, that rating is important to our company and to our board. Hey, on the insurance piece...

>> OWEN Yeah Steven, can you repeat the third part of that question it didn't come through quickly.

>> STEVEN: Yeah i may has misunderstood. There was a reference to the Benmore contracts you've taken, the Benmore contracts insurance?

>>MIKE ROAN: Yes, I though that's what you were thinking. When we were thinking through whether NZAS might or might not exit through the year we thought it reasonable to put in place some sales at Benmore given the prices available in the market. About 50 megawatts of sales, 2022-23 that were placed and made on ASX back in February/March this year. So that's - that's what I was referring to.

>> STEVEN: No worries, that's crystal clear. Thanks, guys.

>>MIKE ROAN: No problem.

>> ANNOUNCER: No further questions.

>> NEAL BARCLAY: With that, I think we'll conclude the call. Thank you. We're obviously open to questions outside of this environment, as is normally the case. Thank you for attending. Goodbye.

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