Meridian Energy Financial Results Announcement – 25 August 2021 – LIVE TRANSCRIPT

>> NEAL BARCLAY: Welcome to the 2021 Annual Result briefing. I'm Neal Barclay, Meridians Chief Executive and I have on my virtual left Mike Roan, our CFO. I'll make a few opening remarks before we get into the guts of the presentation. Most obviously, we saw quite a shift in financial performance in FY21 compared to the previous two years.

FY19 and FY20 saw successive record results powered by strong generation and growth in retail sales. This year, we maintained our customer growth momentum. However, we ran into tough drought conditions that reduced our generation capability and increased our hedge cost.

That's just the nature of the business and the variable New Zealand weather. In January we also completed negotiations with the owners of the Tiwai Point Aluminium Smelter to extend our electricity supply contract until the end of 2024. That extension was done at a significant discount to the existing contract. Both of these events impacted financial performance with EBITDAF and Underlying NPAT down of prior year by 15% and 27% respectively. But we do believe the underlying drivers of future business value are strong.

In particular: Since 2018, it’s worth noting we have grown the size of the combined New Zealand Meridian and Powershop customer bases by 20% and the volume of energy sold through retail channels by 40%, and our sales momentum has not wavered this year. We believe there is still plenty of scope for further growth and enough liquidity in hedge markets to allow us to manage the risk.

Our Harapkai wind farm construction is underway in Hawkes Bay, and our development pipeline is rejuvenating. We’re also buoyed by future opportunities that are starting to take shape beyond the smelter’s exit in 2024.

Ultimately the outlook for growth in the sector is huge as Aotearoa embarks on a path to Net Zero emissions by 2050. But there are some challenges our industry must manage on the decarbonisation journey. The ‘own goal’ the electricity sector managed to score on 9th August by causing widespread customer outages, is just a symptom of a broader contextual issue that the industry must address.

The industry is emerging from a period of around 13 years where we have seen no discernible growth in demand.

Accordingly, the system hasn’t been under real pressure to accommodate new levels of peak demand as occurred on 9th August.

It has also become crystal clear over the last three years that the flexibility and reliability of the gas supply chain, from gas field through to generation, has eroded considerably.

And whilst there is investment going into the upstream gas assets, the situation may be exacerbated by the inevitable growth in renewables that are displacing base load thermal generation at a rate of knots. Waipipi, Turitea, Tauhara and Harapaki combined equate to 8% of current demand despite muted demand growth.

I don’t think anyone doubts the importance of reaching a zero emissions economy, ideally sooner than 2050. But the introduction of the 100% renewable electricity target by 2030, has rapidly upended the wider industry’s long-standing plans to use gas, in particular fast-start gas peakers, to provide renewable firming capacity, and to efficiently transition away from coal.

Now I doubt there will be one silver bullet solution to enable a seamless transition and some of the renewable firming initiatives being mooted presently are still well over a decade away. So, we do need Government policy that is more sympathetic to and accepting of some gas generation. Also, what happens to the load currently contracted by NZAS through to 2024 is a relevant consideration to any package of options to enable a seamless transition, as are efforts to enable large scale demand response from existing and new industrial energy users.

I think the future is bright, but we do need to be smart in tackling the transition to a renewable grid to ensure the continued affordability and reliability of electricity to New Zealand consumers. I'll talk more in this presentation about some of the actions Meridian is taking to invest in the decarbonisation challenge.

The New Zealand customer growth momentum was mirrored in our Australian Powershop business and we are super proud of these results. Succeeding in Retail is down to the proverbial 'battle of inches' and there is no single ingredient that I will point out in our secret sauce. It is really about getting every aspect of the customer offer and service experience just right. And to do that you need great people and a culture that cares. The really good news is we know where we are now, and we know we have plenty of potential to improve.

While lower cash earnings reflected the impacts of the drought and NZAS renegotiations, the Board was comfortable maintaining the ordinary dividend at the FY20 level, albeit at a higher pay-out ratio.

To help accelerate decarbonisation, we kicked off our Process Heat Electrification Programme in February. And it is super encouraging to see the growing commitment from businesses wanting to decarbonise their industrial processes. We already have 171GWh of annual load under MoU and we are close to having a further 100GWh signed up. Meridian can bring to the table sharp long-term pricing but an emerging barrier to getting more of these projects up, particularly as it relates to the financials, is the cost of transmission and distribution upgrades.

Businesses are clearly trying hard to decarbonise and this infrastructure is critical to support a timely transition to cleaner process heat for New Zealand. Accordingly, many conversion opportunities are dependent on the timing of funding awarded from the Government's $69m decarbonisation fund. Process heat electrification opportunities typically deliver a low cents per tonne of carbon abated equation, and if appropriately supported, will deliver a great outcome for customers and our country.

As an example, the coal boiler replacement at WoolWorks in Timaru will reduce emissions by 11,000 tonnes a year. This is the equivalent of taking around 3,000 cars and their emissions off the road.

With very small operational emissions, the bulk of Meridian's footprint is in our supply chain and its pleasing to see our partners making improvements in the quality of the measurement, reporting and the quantity of their emissions.

We continue to make positive progress in our gender equity measures but as you can see from the chart, we clearly have more work to do.

Last year's Covid lock down coincided with our staff engagement survey so we saw a natural lift at that time. I guess our people were thankful to have our support and the job security we promised. This year's survey results have returned to pre COVID levels, we did expect that and these results are still sector leading.

I’d like to call out the great work our people continue to do in this Covid affected world. They have been positive and flexible, and as a business we haven’t missed a beat. I’d particularly like to acknowledge our teams based in Victoria; they’ve endured more than a year of COVID related restrictions, and their commitment and resilience is amazing.

I’ve talked before about my concerns around our annual rate of injuries. While none of the 18 LTI’s resulted in serious harm this year, our people do operate in challenging work environments and we have a lot more work to do to ensure they can continue to do that safely. Safety leadership and safety culture are the focus of a new programme of work being led by Tania Palmer (our Chief People Officer).

We showed investors our refreshed strategy at our May Investor Day. We also indicated the start of an ownership review of Meridian Energy Australia. Mike will update you on that process later. We have evolved some targets since May. For example, Mercury’s acquisition of Trustpower’s mass market book gives us the opportunity to focus on a more appropriate medium-term target for our retail business around fixed price growth.

And as we deepen our development pipeline to accelerate decarbonisation of this country, we’re now aiming to have 3 options ready to build by the end of 2024. I’ve talked previously about the roadblocks the industry faces getting potential sites through consenting, so this will be a real challenge and does require support though the Government’s RMA reform process.

We’ll touch on progress against most of the targets through the course of this presentation.

Work with stakeholders has helped us distil our sustainability focus down to the 10 material topics presented here. Those topics inform our activities and I’ll call out a few successes over the last year.

It’s easy to forget Meridian is already net zero carbon and we are now planting forests to create our own carbon offsets.

By the end of 2021 we will have doubled the number of trees currently in the ground, but we do need to seriously pick up the pace. Pleasingly, we recently acquired two additional parcels of land to accelerate our planting programme.

Meridian’s own EV charging network was launched earlier this year. We are deploying mostly AC chargers that integrate well into existing electricity networks. They are ideally suited to shopping malls, retail and business parks and community facilities. International experience shows AC charging offers an efficient complement to fast DC chargers.

We published our first modern slavery statement. The statement sets out our actions to assess and address modern slavery risks in our operations and supply chains. And we have now just presented our third TCFD report.

Where Meridian puts its social focus is well established. We have long term commitments to our generation communities, supporting local projects that are important to them. KidsCan, Kākāpō Recovery and Project River Recovery are amazing causes that I am personally honoured to be part of.

We specifically acknowledge iwi rights under the Treaty of Waitangi. It is important for us, as a large user of natural resources, to partner with iwi in finding ways to deliver improved environmental, commercial, and cultural outcomes. This isn’t just corporate speak - we are working actively with many iwi groups to make a real difference.

We've been talking about the green shoots of demand growth for a few years now.

The impacts of Covid and Tiwai's 4th potline consumption skews things a bit from prior periods. But if we normalise for those, we see demand uplift in the last two years. And that is despite near record temperatures taking the top off winter demand.

Whilst the return to a Nationwide lockdown must have an economic impact, we have not seen anywhere near the same level of negative impact on demand that was evident last March. But it's early days.

As I mentioned earlier, the customer growth we have achieved in retail volume and customer numbers has been a standout in the last few years. And we have achieved this without big movements in headline prices.

The project to move Meridian's customers across to the Flux Platform is in its final stages and focus is now on the remaining complex Corporate and Industrial customers. I'd like to acknowledge the Meridian Retail and Flux Teams for doing an amazing job. They have reimagined and rebuilt our customer service operating model and migrated 95% of our customers to the new platform. The truly amazing bit is they have done that whilst losing no momentum in sales and creating close to zero disruption for our customers.

There is no doubt electricity pricing is an emotive topic full stop. And high wholesale prices have been exercising many in the market and in the media over recent times. But there is still plenty of evidence to show the sector overall is delivering great outcomes for New Zealanders across the Energy Trilemma.

The price graph here, which is MBIE published data, tells quite a story. Historically there has been a significant rebalancing of electricity prices across sectors – I think that is well understood. It also shows though, that in real terms, overall market prices have not really increased since the 1980s and during the last 10 years, other than the industrial sector, most customers have experienced real price decreases.

And lastly, the hedging strategies adopted by most retailers have meant the vast majority of customers have been insulated from these higher wholesale prices, that we've seen of late.

Also, the price for electricity in New Zealand compares favourably with other OECD countries and in particular, as of last year, large C&I customers, paid the seventh-lowest price in the OECD.

But that is of little comfort if you are a large business trying to recontract supply in this market and the high wholesale prices we are seeing are certainly cause for concern.

Meridian has not stepped away from any customer and have provided pricing solutions including terms of 5 and 10 years to help moderate the impact of current pricing on those customers.

We have clearly seen prices moderate as hydro storage has recovered; they still remain relatively high however. But that doesn't mean we are seeing inefficient price signals or a broken market.

I will touch on the drought shortly, but it's worth noting that both Meridian's Waitaki storage and the national hydro storage only just got above average for the first time this year in the 3rd week of July. Droughts cause high prices and we have seen that many times before.

Underlying the variable weather is the well documented degradation in gas deliverability that emerged in 2018. The outlook may be on the improve as investment programmes at major producing gas fields are underway or are better defined. But simply put - right now - the system has less fuel storage and capacity available for it to meet demand than we have enjoyed over most of the last decade.

We're seeing the industry respond with several new renewable projects, that will deliver around 8% of electricity demand at a cost of $2bn. These projects are in construction or nearing full commissioning right now and more new developments are also being signalled.

But these stabilising initiatives take time to turn up and given hydro water values reflect scarcity, we believe supply risk is still being priced into the spot and electricity futures markets.

My view is the long-term trend in prices is likely to be down as new renewables become cheaper to build. But we are also likely to continue to see considerable short and medium term price volatility (both up and down) as the percentage of renewable energy increases. The risk management strategies adopted by businesses will need to account for that volatility.

I mentioned earlier that there is sufficient liquidity in wholesale hedge markets to enable us to manage the portfolio risk of further retail growth.

This chart shows just how successful the reform of the electricity hedge market in 2009 have been. The volume of Exchange traded ASX Futures has trended up to be similar in size to the physical market and FY21 volumes far exceeded the physical energy traded. As you can see Meridian has put significant capital at risk and continues to do the heavy lifting in supporting the ASX growth.

ASX is only part of the story. There is also a strong Over the Counter market in New Zealand and a growing market for long term Power Purchasing Agreements as new developments are being kicked off.

So I think there's plenty of liquidity and opportunity for parties to manage risk and their exposure to wholesale prices should they chose to do so. But of course, there is also no point in waiting until your house catches fire before attempting to buy insurance.

The Electricity Authority has an extensive market improvement programme in play. Of late we've seen the implementation of many of the Electricity Price Review recommendations and we've had an overhaul of the trading conduct provisions that was needed.

The final decision on corrective actions for the December 2019 UTS has been published. As expected, the cost to Meridian was within the $5m (before tax) amount we provided for in last year's accounts.

More recently the events on the evening of 9th August created a very poor outcome for affected customers. I can assure you that the Industry's collective failure is felt most acutely by those of us who have a responsibility toward our customers. I'm certain all parties will want to ensure learnings are taken on board and we avoid a similar outcome occurring again.

As I mentioned at the start, the industry is moving quickly into a decarbonisation phase that will have bumps along the way. So there is a broader contextual conversation that also needs to take place.

2021 saw the landmark final advice from the Climate Change Commission to Government on its first three carbon budgets. The Government now has until the end of the year to set these budgets and release the country's first emissions reduction plan.

Already there is movement on Government policy. The Clean Car Discount has been launched. And Government have implemented further reforms of the Emissions Trading Scheme.

From my point of view, this sets New Zealand on the path to its low carbon future and the electricity sector is the biggest enabler of this future.

Notably the Climate Change Commission have recommended consideration of a 95%-98% renewable electricity target, which would allow for a longer runway for gas to support system flexibility.

And this month, Transpower published its new Transmission Pricing Methodology. This offers an updated estimate of what Meridian could pay in transmission costs once reforms are implemented. However, we understand that The Electricity Authority has asked Transpower to rethink some aspects of their proposed methodology and further consultation will take place later this year.

The TPM saga continues.

Back in January we reached agreement with Rio to extend our contract with the Smelter to the end of 2024. And it is fair to say that since then, we have enjoyed plenty of constructive feedback about the extent to which we were taken to the cleaners. Looking at where LME prices have gone since, it certainly would appear Rio got the best of that deal. But at the same time, they have lost any option of a guaranteed electricity supply agreement beyond 2024.

I think most people understand the revised NZAS agreement is a cents in the dollar type arrangement, designed to buy time. Time for the Southland Region, the Electricity Sector and Meridian to transition away from a significant employer and user of energy, and to do that in an orderly fashion.

I guess this would be a far more interesting results briefing for all concerned, if we were contemplating the smelter turning off all their Pots next week as could have been the case.

The key thing is we are making the most of the time we have to mitigate the impact of the smelter closure. You'll be familiar with the plan as described on this page, and I'll just quickly go through the latest on some of the options.

The swaption replacement discussions continue with various parties. We think a portfolio of options is emerging and as part of that, the Smelter Demand Response, within the existing agreement with NZAS, will likely take on a greater degree of importance.

The Clutha to Upper Waitaki Lines Project continues to track well and Transpower do not envision any significant time delays.

We aim to secure a North Island battery site by the end of September. Whilst the battery concept grew out of a desire to create greater effective capacity on the HVDC, an asset like this would have also made a big difference during an event like 9th August. So, we've upped the priority on this project and are looking at ways to bring forward deployment to late 22 or early 23.

Earlier this month Hawaiki Submarine Cable Ltd (owned by the founders of Datagrid) was sold to a large Singaporean private company, BW Group Ltd. We view this as a positive development, both for getting the subsea cables required for Datagrid installed in Southland, and more broadly for Datagrid itself. We expect to see significant focus on the Datagrid opportunity over the coming months.

The Hydrogen Registration of Interest jointly prepared by Contact and Meridian was issued to the market on the 22nd July which coincided with the public release of the McKinsey report and the launch of the Southern Green Hydrogen website. Counterparties have until the 10th September to submit their responses. We'll evaluate the responses by early October, then enter into more detailed commercial and technical discussions with shortlisted counterparties.

In parallel we are progressing engineering prefeasibility work that will support future counterparty discussions. I think we're making really good progress, across a range of options.

I'll finish with some comments on the severity of this year's drought. Our analysis shows it was the third worst drought we have seen in the Waitaki catchment. The amount of water that didn't turn up in FY21 compared to FY20 was the equivalent of the entire Lake Pukaki operating range.

Twice over.

Our catchments are generally fed by a small number of significant rainfall events each year and there was clearly a lack of those between November and June. That's part of what we deal with and I think we managed our portfolio well through that prolonged dry period. Mike will add more colour to that shortly.

The good news is inflows in the last two months have now alleviated our fuel squeeze and we've started the new financial year in reasonably good shape. I'll now hand to Mike who is Leading our MEA Ownership Review. And he'll also drill into the numbers with a little more detail. Over to you Mike.

>> MIKE ROAN: Thanks Neal, and thanks everyone for joining the call this morning.

I am going to talk very quickly to the review of our Australian business before cracking into the financials. As always, I will try to provide a little more insight than you might see on the slides directly so showing up is worth your time.

Right, we announced that we were considering an ownership review of the Australian business during our investor day back in May. We followed this up with an NZX announcement early June and following our Board endorsement.

We released a flyer during July and last week followed this up with an information memorandum to parties who have entered into a non-disclosure agreement with us which created a bit of media and speculation on both bidders and proceeds.

All I'd would say is don't count your chickens yet as it won't be until later this year, all going well, that we decide whether ongoing ownership offers the most value to shareholders or alternately a partial or full sale. And to get ahead of any questions, the reason we are looking closely at our business in Australia is twofold.

First, we noted that investors seem particularly interested in entities like Meridian Australia. And second, the increasingly fragmented and interventionist electricity policy at state and federal levels in Australia concerns us.

That said we do like Australia's long run prospects as it must also transition to renewables and the challenge there is larger than it is in New Zealand. So time will tell but retaining an organic proposition in Australia remains an option for us.

But back to FY21 financial results. It was an interesting and challenging year for us.

In terms of the year itself, I think my comments at Interims are a good place to start. If you recall, we had a decent first half with EBITDAF of $422m which was down by about $43m on FY20 but still represented the second best first half performance ever for Meridian.

However, my key point from February was that we had run into a dry patch by November and had started using hydro storage to deliver revenue while we waited for summer inflows to arrive.

I didn't know it at the time, but those inflows wouldn't arrive until mid-May and the lack of rain would put a material dent in both storage and our opportunities.

By late April, Lake Pukaki was approximately 700GWh or 53% below average for that time of year.

So that drought, alongside the renegotiated Tiwai agreement that kicked in on 14 January, meant that second half EBITDAF was well down the prior year, $81m to be precise.

As a result, full year EBITDAF fell by 15% from $853m last year to $729m this year. At the same time underlying net profit after tax fell by 27% from $316m last year to $232m in FY21.

Now both EBITDAF and underlying NPAT are non-GAAP measures and if you look at our net profit after tax you could be fooled into thinking we had a bumper year. The reality is that the majority of the difference between underlying NPAT and NPAT itself was driven by unrealised gains on electricity and treasury instruments which do not translate into cash.

So don't be fooled.

And the best way to measure how the year went, at least from my perspective is by tracking operating cashflows. They fell by 29% from $604m last year to $431m in FY21.

Now don't get me wrong, our performance remained sound during the challenges we faced, we just didn't do as well as we did last financial year, so let's move on to dividend before diving into a bit of detail.

As Neal mentioned, there are no surprises in the dividend space either.

We are rolling the FY20 ordinary dividend through to FY21. That means that a final ordinary dividend of 11.20 cps will be paid on 15 October and in turn, the full year ordinary dividend will remain at 16.90 cps imputed to 86%.

One thing I do want to pick up here is that the Board has approved implementation of a Dividend reinvestment plan. We had signalled this a couple of times this year and as result, shareholders will have the option to participate in that plan.

Those that do will be able to buy shares in Meridian with their final ordinary dividend proceeds at a 2% discount to the market value of those shares. Documentation that describes how the dividend reinvestment plan works is being sent out as we speak.

Simply put, performance in New Zealand was sound in some areas and outstanding in others and there are a few things to reference on this slide.

First, Energy Margin was $128m lower in FY21 than it was last year.

As mentioned above, there was good reason for this as while wholesale prices soared, we faced a pretty sizeable drought in the second half. And while some uninformed commentators think we do well in these circumstances, the more nuanced know that it tends to create challenges for us. And those challenges are pretty simple, without an adequate supply of fuel we could end up short to those wholesale prices.

Now, we're fortunate that our wholesale team puts a lot of thought and effort into managing our portfolio in these circumstances. As a result, we did not end up with spot price exposure but the hedges we bought, and the lack of fuel weighed on energy margin delivery.

For a drought as substantial as it was, the wholesale team did a superb job.

And as I have said before, we also have a pretty decent Retail team – in my view they are the best out there – and they did a stellar job lifting contracted revenue by $149m as shown on the waterfall.

Now I know that some of you might be thinking that if we hadn't been focussed on developing customer relationships that we would have had stronger Energy Margin.

That is possibly true, but it is short-term thinking and what really matters is long term success. And if you pick up any business textbook, it will tell you that's only possible if you have strong relationships with those who use your product.

And whether you are an electricity business, a lust filled teenager or Amazon, relationships take time to develop. You might be wondering how teenagers fit into that category, well they don't.

My current lockdown experience cooped up with a couple of them suggests that they are too focussed on short term goals to think about longer term relationships.

Anyways, I'm off message and getting into dangerous territory particularly as one of them might bound down the stairs if they are listening to this.

What I am trying to say is that we have been really clear over the past few years that our focus has been centred around customers first and while that might cost us a little in the short run, we are confident that in the long run it will serve our investors well.

And I know that there are folk out there that will think that we are simply looking to extract more coin from them. But that is a cynical view.

The reality is that if someone values what you do, they will gladly pay you for your services and possibly stick with you through the tough times. And that is what we are trying to build. So far, the data shows that we are doing a reasonable job of it.

But since I mentioned cynicism, this also feels like the right place to focus a little on commentary on the wholesale market, particularly commentary that suggests it is broken.

My only request to you is that you ask yourself why folk might be saying that.

Yesterday provides a useful example, as yesterday a group of large New Zealand businesses attacked another, us, for making too much money……with the sole motivation of lifting their own profitability.

Go figure.

Now this was both surprising and disappointing but given the underlying motivation, you have to be sceptical of the claim…. particularly as the government looked into excess profit as part of its electricity price review in 2018 and found nothing and our own independent analysis, completed by PWC, aligns with the government's findings.

We have released those PWC conclusions, but I want to come back to my key point……consider the motivation for claims before deciding whether they are credible, as opposed to buying into the rhetoric directly. Where you see business attacking business, there will be an economic motivation

And we know that some MEUG members were exposed to the high wholesale prices seen in 2021 and that they want those prices to fall.

We get that, but I would point out that in this case the electricity industry has responded ahead of them by committing to approximately $2b worth of new generation development in response to those prices.

And those investing are not just incumbents; we are seeing new entrants step into the electricity market and invest as well.

This is the exact response you would expect from an effective market. This is a complex industry and silver bullet fixes do not exist. And while kicking off in the media might make you feel better, it tends to distract from managing the challenges we face.

The good news is that over the past 20 years that the market has been in effect, there has been substantial progress in terms of market design and levels of competition even if over that same period we have had a few moments that we wish we could have back. We are always striving to get it right but perfect does not exist unfortunately.

But the progress has been substantial enough for residential customers to see pricing, security of supply, sustainability, and product choice benefits.

That might seem like a strange thing to say following the events of 9 August, but as I said this is a complex industry and when things are complex, they don't go right all of the time.

The industry actually has a pretty decent track record – at least compared to the period before the market existed – and we need to give folk time to work through how such situations might be avoided in future.

In the meantime, the data that I see and Neal referenced, suggests that residential customer costs per unit are lower today in real terms than they were in 2013.

I should point out that Industrial customer per unit costs are rising but they are still approximately half of the cost that residential customers pay. That is pretty decent empirical evidence as it means that for residential consumers, electricity is a smaller part of peoples cost base than it was back in 2013 at least in inflationary terms.

And to top it off, the International Energy Agency last ranked NZ's electricity market as the 10th best in the OECD and New Zealand is the only non-European country in that top 10.

We also get the International Energy Agency's highest rating of AAA and a pretty solid sound bite in that "New Zealand….is a world leading example of a well-functioning electricity market, which continues to work effectively".

We know that the IEA will update its rankings in October so we will get to see if that view changes, but that is where my security of supply comment came from.

Anyways, the facts suggest that residential customers are benefitting from what has played out within the electricity sector and our team will continue to work out how we attract more of those customers to Meridian.

Right let's talk about Australia.

The key feature on this slide is the fall in generation spot revenue.

As I have noted in the second and third bullets, generation volumes were sound but wholesale prices fell materially, and this drove the $39m reduction in Energy Margin.

In turn, this flowed through to EBITDAF which fell from $66m in FY20 to $38m in FY21.

The good news is that wholesale prices lifted towards the end of the financial year and if you have seen our operating stats for July, financial performance has improved materially.

That said the customer story in Australia is similar to how I presented it at Interims – since lockdown the growth in customer numbers has slowed even though customer revenue has grown on the back of a 20% lift in household consumption due to lockdowns in the lucky country.

So, growth in customer numbers slowed but the team in Australia remain committed and they once again lifted the Roy Morgan Electricity provider of the Year and Canstars most trusted energy provider award so the opportunity for growth remains.

Now I always like to say something about large generation certificates or LGCs, largely as we do not have or need such certificates in NZ.

But the team in Australia both create and then sell LGC's from our renewable generation assets. Unlike previous years, where hedging of LGCs added value to the business, this year mark to market losses from them were $3.3m and hence derivative sales and purchases were well off FY20 levels.

And I will finish with my other favourite when talking about Australia, hydro storage.

Good news.

Storage at both Burrinjuck and Keepit hydro power stations is full and at Hume, storage is higher than at any time Meridian has owned that asset – I suggest you look at the Hume graph on the Goulburn-Murray website so you can see what I mean. So, it looks like we will get decent generation volumes from those facilities this year.

This is a new slide, but we added it as we think it provides some useful insight.

First it sets out that we, like all retailers, pay the spot price for electricity consumed by our customers.

It doesn't matter whether a company is vertically integrated or not, the New Zealand Electricity Market ensures a level playing field for retailers.

This slide also builds on the New Zealand Energy Margin slide that showed that the cost to supply customers has grown massively, and here we show that, at $184/MWh, the price paid to support our customer base in FY21 was about $89/MWh higher than in FY20.

And finally, it highlights the internal transfer price that our Retail team buys electricity from our wholesale team at.

As stated on this slide, it was $81/MWh in FY20 and it lifted to $88/MWh in FY21.

What isn't as clear from this slide is how we calculate that price. But that isn't complex either. I'll summarise it here.

We simply assume that a Retail business would hedge its risk progressively over a 3-year period and the FY20 and FY21 ITPs reflect that – the average of the previous 3 years ASX prices for the relevant financial year, shaped on a volume weighted basis based on our consumption profile.

Of course, there are more important issues than internal transfer price, but we thought it was useful to capture this information.

So, on to operating costs.

There is always a bit more in this one than I think is necessary so long story short, we showed discipline again in FY21 in relation to costs.

At this time last year, I stated that we expected to spend between $261m and $266m. And we spent $265m.

And while that is a lift of $6m on last year, by the time you strip out the accounting adjustment for Software as a Service (SaaS) and the holidays act provision then underlying operating costs lifted by $3m during FY21 and that increase was directed towards our development activities where we continue to ramp up effort to ensure we have sites available to meet expected decarbonisation growth.

For those not versed in the SaaS adjustment referenced here, in April IFRIC – the International Financial Reporting Interpretations Committee - revised its policy in relation to costs incurred implementing SaaS arrangements.

Long story short, and following that policy revision, all costs related to SaaS should flow through the P&L as operating costs as opposed to recognising those costs as intangible assets on the balance sheet and amortising them over time.

Given this decision, we have presented a small restatement for FY20 and in FY21 SaaS costs amounted to $2m as you'll see on this graph. For those that would like more detail, see page 122 of our annual report.

Second to last comment. While it isn't captured as a cost item here, we have retained an elevated provision for doubtful debts from in FY21. At $9m, it is lower than the $15.7m provision held in FY20 but it is approximately $4m higher than levels held before COVID showed up. How it moves in time, will depend on how the economy navigates this virus.

With that in mind and during the first week of lockdown, electricity consumption looks like it is down by 7% which isn't substantial compared to lockdowns in 2020 where consumption fell by between 16 and 19%. That could change of course, so we will see how things progress.

And finally, we estimate that operating costs will fall in the $275m to $280m range this financial year, largely driven by $6m of SaaS costs flowing through the P&L with the remainder driven by ongoing focus on development and lifts in insurance and employee costs.

I talked about NPAT and Underlying NPAT at the start, so I won't dive into it too much here.

As the two graphs show, our preferred measure of performance, underlying NPAT fell by 27% from FY20. I am sure that this makes sense to most of you given explanations provided earlier in this presentation. And it shows that year on year our cash performance was impacted by the drought.

And while NPAT lifted by 145% the key difference between the two measures is fair value movements in both electricity and interest rate derivatives. These are non-cash items that can move materially year on year.

For example, in FY20, electricity derivatives reduced NPAT by $113m but this year lifted it by $169m so they can move around considerably.

My simple message is that FY21 was not the record year that FY20 was.

Other than for that, in Australia we saw a gain from changes to Australian generation asset remediation costs and while it isn't shown here, the value of Mt Millar and Mt Mercer Wind Farms were stable and the GSP asset values lifted by $55m.

I don't have too much to add to the statements captured on this slide

Stay In Business (SIB) capex remains stable at approx. $50m but the decision to move forward with Harapaki and the ongoing work to cut over our customer platform to Flux meant that investment capex was $72m which is well up on prior years - Harapaki consumed $41m of cash and the cutover to Flux - much of the remainder.

And while I am on the customer platform cutover, the customer team delivered the impressive results while this was in progress and there haven't been any material issues for customers or our business in completing this 3-year project.

We are pretty sure that customers are going to love what they see in the coming months as we finish the migration of C&I customers onto the Flux platform and then start optimising it.

I will leave you with our forecast capex range for FY22 which is $205m to $215m, where I expect SIB capex to be similar to FY21, with the residual largely attributed to Harapaki and Australian development activities.

Obviously, we will revisit this when we have determined the outcome of the ownership review.

And our balance sheet remains a straightforward read.

Net debt lifted by 9% over the year to $1648m and while net debt to EBITDAF lifted from 1.8 to 2.3x, S&P removed the negative outlook from our BBB+ credit rating following completion of the NZAS transaction.

So, I will finish as I started. It has been an interesting and challenging year for investors in Meridian.

Our team is focussed on working through the transition away from aluminium as directly as it is focussed on the economy wide transition away from fossil fuels.

We need to put our best feet forward if we are to make that transition a successful one for both our shareholders and NZ.

Neal, back to you.

>> NEAL BARCLAY: Thanks Mike, I think you summed things up quite nicely there. I'll just make a few concluding comments myself.

I think what you see in Meridian is a high performing business with a culture that is values based. And our customers understand that about us.

You can expect us to be very focussed on mitigating the loss of the aluminium smelter, but in doing so, we will not lose sight of the big picture and we will continue to focus on our customers and supporting New Zealand's decarbonisation goals.

What you see in the Electricity Sector is an industry that, whilst not perfect, does deliver world leading outcomes for New Zealanders across the trilemma of reliability, sustainability and cost. Most importantly the market is delivering clear investment signals and the Industry is responding.

I think we'll wrap it up there. And we'll move to questions. Obviously, there's none on the floor today so we'll be going online.

>> Thank you very much, Sir. Ladies and gentlemen, we will now begin the question-and-answer session. As a reminder, if you wish to queue for a question, please press 0 followed by 1 on your telephone keypad and wait for your name to be announced. That is 0, followed by 1 on your telephone keypad. Thank you.

Your first question is from Andrew Harvey. Please go ahead. Thank you.

>> ANDREW HARVEY Good morning, guys. A couple of questions from me. First of all, just around sort of understanding some of the optics and the increase there, guess from my perspective, I'd expect a little bit of debt coming through from the Flux and some benefit coming through from that. Is that still expected? Or has anything changed there?

>> NEAL BARCLAY: Mike, it's talking about the benefits from Project Momentum. Do you want to cover that?

>> MIKE ROAN: Andrew, what you've seen is customers servicing costs have held flat. In fact, decreased slightly over time. We'd expect that to continue in the coming years. Where we're really focused on making sure we've got the right cost base is in the development space, which is why I pointed it out as part of the fin year 22 forecast.

>> ANDREW HARVEY: And what about down-the-line cost? They'll probably be flat and deliver on the other side?

>> MIKE ROAN: Sorry, Andrew, I missed that. I think I got the gist of it, but I missed some of it. I said it last year, at our announcement results as well. That the delivery of that programme is delivering real cost benefit. But what you see is the growth in customers, and that's growth associated with growing that customer base so every time you pick up a customer there are metering and field service costs alongside internal costs.

The Flux platform, what it's allowed the customer team to do is manage and gain efficiencies in our internal cost base, even while we've added a material volume of customers to our business and we expect that to continue over time. So it's well and truly delivered business case benefits and the efficiency outcomes that we expected from it and we're actually pretty proud of the fact that we're holding those customer costs flat to falling slightly while we're growing our customers base as materially as we have.

>> **ANDREW HARVEY:** OK. Second question is (SPEAKS INDISTINCTLY). I'm looking at the slide about CAPEX and: (SPEAKS INDISTINCTLY). Is that the kind of thing for the long-term going forward?

>> NEAL BARCLAY: Andrew, I think you're really breaking up, but I think you're talking about stay in business CAPEX. So we might give a bit of flavour on how that looks going forward.

>> MIKE ROAN: Andrew, I think if I picked it up, I expect Stay In Business (SIB) to stay reasonably at fin year 21 levels. As you say, I mentioned approximately $50 million and in the slide, it's got $45 million and you can see the trajectory over the past few years. I think that's a reasonable frame for Stay In Business CAPEX moving forward. Where I was trying to get people to pay attention is the growth CAPEX as it related to Harapaki and possibly development in Australia if we continue the owners of that business. Does that give you enough?

>> ANDREW HARVEY: Yeah. That's OK. Thanks. The last question may be hard for you to hear again. But just around the Swaption Contract. You talked about the smelter perhaps getting involved. Am I right in saying that's the first time that they have even been talking about (SPEAKS INDISTINCTLY)

>> NEAL BARCLAY: I'm sorry, Andrew. I didn't get the gist of that at all. It was something about the smelter. Mike, did you...?

>> MIKE ROAN: Andrew, I'll try and paraphrase it. Is you talking about swaption replacement and Neal's comment in replacement to the SDR, the Smelter Demand Response.

>> ANDREW HARVEY: Yeah, that's right.

>> MIKE ROAN: And I think you were wondering whether we had had any sort of conversation with Rio in relation to demand response following the conversations last year and the answer to that is no, we haven't had any engagement with Rio Tinto on their activities since the conversations we had with them last year. What Neal was referencing is we're looking more wholly at a package of supply and demand options to manage the underlying hydro in-flow risk and we can see, is the smelter demand response component of the Rio agreement in FY23 and 24 could form part of that package. So, it's an existing arrangement we have with them rather than anything new.

>> NEAL BARCLAY: I'll add to that. It's an existing arrangement. We can envision better arrangements that would work for both parties. While we haven't had any conversations with them about those since the extended exit deal was put in place, we made it very, very clear to Rio leadership that if they ever wanted to entertain any thought of remaining in this country beyond 2024, they'd have to bring something to the table that made them operate in a far more sympathetic way with the overall industry as opposed to just being a taker of energy.

>> Thank you, Sir. Your next question is from Steven Hudson. Go ahead.

>> STEVEN HUDSON: Good morning, guys. You can hear me OK?

>> NEAL BARCLAY: Yes.

>> MIKE ROAN: Yes, we're good.

>> STEVEN HUDSON: OK. I just have four questions. You've had a PPE fair value change. I wondered if you could give us some idea around the assumptions around the volume and pricing post 2024 in the fair value change and PPE.

Secondly, maybe one for Neal. Is the gas fuel swaption option acceptable to you post 2022 and then maybe back to Mike. Could you give us an idea of the book value of the Australian assets under review and then just lastly Harapaki, could you confirm you're fully at risk on your civils and if so, what are you seeing in these early days for civil works?

>> NEAL BARCLAY: I'll cover off 2 and 4, Mike and you cover off 1 and 3.

>> MIKE ROAN: Yeah. Hey, so Steve you picked up the fair value movement, you know, PPE lifted by a couple of hundred million bucks. So, the assumption that we're using for NZAS is that it is not connected to the system as part of that valuation. That's the simple assumption is there is no consumption from Rio Tinto so therefore no price, no contract.

And, hey, I'll pick up number three while we're on it which I think was book value of the Australian assets which doesn’t come out through our accounts. I'll be wrong on it because I've got last year's value in mind, but the book value is about $470 million net assets.

>> NEAL BARCLAY: Steven, on your second question, would we entertain a gas fuel swaption? Absolutely. We are in conversations with parties around such a sort of transaction. I would say, though, that the economics have got a lot tougher of late and they need some sort of confidence they can get a return on that investment within a relatively short space of time. That's the sort of issue I'm alluding to. We're certainly looking to work with parties, in the industry to support those sorts of investments because we're going to need them, no doubt about it.

Harapaki, yes, we are at risk at civils. So, we manage the project ourselves and the project has gone into abeyance with the lockdown. There will be some cost of that. But because we're in the early stages of gearing up into the project, the costs are not significant. If we go through further COVID delays through the construction period, those costs will build but we have built in a reasonable amount of contingency for that eventuality to the economic projections before we signed up to the deal.

>> STEVEN HUDSON: That's really useful. Thanks, guys.

>> MIKE ROAN: Thanks, Steve. I just got a text from Andrew who said our call quality isn't the greatest either and he wondered if while the questions are on whether we have both -- whether we both go on mute so we can hear him a bit better. That's a good suggestion.

>> NEAL BARCLAY: You go on mute and I'll throw it to you.

>> Thank you, Sir. Your next question is from the Grant Swanepole. Please go ahead. Thank you.

>>GRANT SWANEPOLE: Good morning. I hope my voice is not double up. Just from Andrew Harvey Green, the latest CAPEX. Mike said $50 million. But the presentation said $55 million to $60 million. Which is it, Mike?

>> MIKE ROAN: Grant, I think if you use $50mil you'll be fine. The forecast we've got for FY22 is captured in the business CAPEX of $55 million to $60 million. We've tended to find our forecasts have exceeded actual capacity to deliver stay in business CAPEX so the number you're seeing, the actual numbers in the preso, tend to be a reasonable forecast for you.

>>GRANT SWANEPOLE: Thanks. Next, data opportunities, exclusivity, have we bought land yet? And when does that exclusivity fall away if he doesn't buy soon?

>> NEAL BARCLAY: Sorry, Grant. Which opportunity are you referring to?

>>GRANT SWANEPOLE: The data centre.

>> NEAL BARCLAY: The Datagrid. I understand they've got conditional offers in on a range of properties, but they haven't gone in conditional yet.

>>GRANT SWANEPOLE: Does exclusivity expire if he doesn't?

>> NEAL BARCLAY: Yes. Our exclusivity expired about - well, up on the original terms about a month ago. We pushed it out based on the progress that we saw Datagrid making. So we gave them another couple of months to land something, Grant.

>>GRANT SWANEPOLE: Thanks. Final question. The 171GWh contracts with a 250 target - does that seem a bit like it lacks opportunistic intent?

>> NEAL BARCLAY: You're talking about the process heat electrification target? Look, we've already MoUs with companies who are actively moving to electrify their fossil fuel use. We've got a couple of

MoUs that I hope to have floating around on my desk in the next day or two, so we'll push 250 to 300 as we sit here today. We've actually increased that target internally.

We think there's the opportunity to go for about 600 and if we can get support from government, particularly around the transmission and distribution cost which is the main hurdle getting economics over the line, then I think that sort of level of growth is achievable and will obviously be a great outcome for the country in terms of reduction of emissions.

>>GRANT SWANEPOLE: That's great news. Thanks.

>> Thank you very much, Sir. Your next question is from the line of Jeremy Kincaid. Please go ahead.

>> JEREMY KINCAID: Hi, team. Hopefully this is clear. First question around buildable options by 2024, can you give some colour on what they are and the potential size.

>> NEAL BARCLAY: I mean we're still fine tuning the portfolio, but there will be certainly one wind farm in there and we'll be pushing through to consent on one of our wind farm opportunities in the not too distant future.

We've got a couple of really promising solar sites coming up that we think we should be able to get to a consensus stage in the not too distant future and we've also got the battery in play and we've got a conditional offering on a parcel of land on that at the moment.

And we think that the progress we've made on the design, we can probably get that deployed some time late last year or early the following year. But I'd say it will be a portfolio of probably battery, solar opportunity and at least one wind farm, possibly two

>> JEREMY KINCAID: And the potential size of the solar and the wind farm?

>> NEAL BARCLAY: The next best option for us is our Mount Monroe option which is in the Wairarapa. I think it's circa 50 megawatts. Is that right, Mike?

>> MIKE ROAN: Yeah.

>> NEAL BARCLAY: Yeah. So, we'll look at big options as well but we think medium-size chunks are ones that are easy to deploy and we can do them more rapidly, more flexibly and the economics are looking pretty compelling for them.

>> JEREMY KINCAID: Cool. Second question. Just on the process heat MoUs. You've made good progress there, but I suppose you're looking to greater than 250 gigawatt hours over the next three years. That seems a bit conservative. Can you talk to that? Relative to the things you've had?

>> NEAL BARCLAY: Yeah, yeah, as I was just saying to Graham, we've internally lifted our sights to 600 gigawatt hours. The opportunity is greater than that, but you know some of those parties are competing... we're competing with biomass as well.

One of the exciting things with this opportunity is, we’re starting to work through options to enable these customers to provide demand response back into the system, so that they can for keep some element of their existing infrastructure in place and can either run it on biofuel or coal if need be. You're making a step by moving the bulk of their usage off those fuel types onto electric in the first place. We think we can do it in a way that provides quite a lot of flexibility back into the system. But you're right. 250 is soft and we're revising our internal view as to what's possible.

>> MIKE ROAN: Jeremy, I might just add a touch to that. There is a massive opportunity out there for fuel conversion, as you know if you've seen any of the reports floating around. The biggest constraint we've got is network Transmission Pricing. We'll need some form of breakthrough if we're going to see numbers bigger than what Neal has mentioned in the way that Transmission distribution charges is allocated to new customers cutting across. That's an area that will challenge not only what we're trying to do but will form the plank of what the Government is doing to try to decarbonise the economy. That's what will limit opportunity. The economics are lining up probably better than we expected but that one there is a bit of a challenge.

>> JEREMY KINCAID: Great. Thank you. That's all from me.

>> Thank you, Sir. There are no further questions at this time. I'd like to hand the floor back to the speakers for any closing. Please go ahead. Thank you.

>> NEAL BARCLAY: OK. Well, there's no further questions so we'll call an end to it there. Thank you, all for attending. Sorry the call quality was obviously a bit average when we were doing questions but there'll be plenty of opportunity in the coming days to talk to most of you and field any other questions you have. Anyway, have a good rest of your lockdown. Enjoy the rest of the day. Thank you.