

25 October 2022

Contact Energy Limited (CEN)



The company will hold its Annual Shareholders Meeting at **10.00am Wednesday 16 November 2022.**

The location is **The World Cup Lounge, Level 4, South Stand, Eden Park, Auckland.**

You can also join the meeting online [here](#).

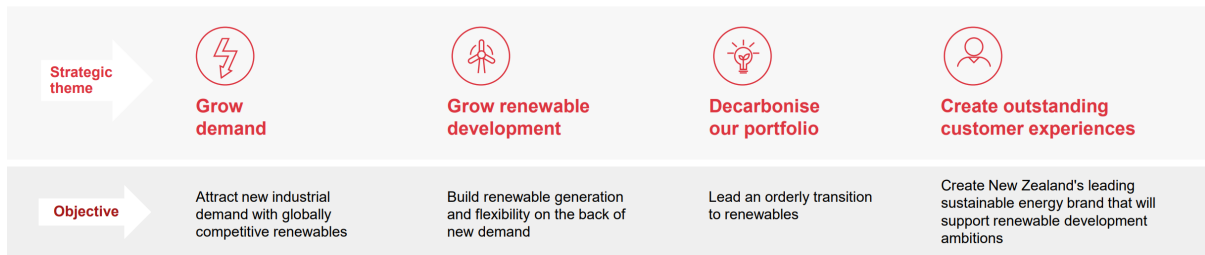
Company Overview

The company is the second largest energy supplier in the country delivering 20% of the country's electricity generation. It also offers broadband services. It operates 5 geothermal, 2 hydro and 3 thermal power stations producing 8.3TWh of energy, 81% renewable. The company has 1,179 employees and 580,000 customers, with 100,000 using its apps and website to self-service their requirements.

In February 2022 it issued an update on the Tauhara geothermal power station near Taupō advising it is progressing well and is now expected to generate 168 megawatts, up from 152 megawatts when the investment was announced a year ago. In June 2022 the company announced it will close its 44-megawatt Te Rapa power station in June 2023, reducing the company's long-term scope 1 and 2 carbon emissions by 20 per cent per annum.

Current Strategy

The Contact26 strategy was developed in the second half of FY21 and sets out the company's plan of action for the five years until 2026. There are four key themes at its core: Growing Demand, Grow renewable development, Decarbonise the portfolio and Creating an outstanding customer experience.



Their latest Annual Report is structured around the Contact26 strategic themes and enablers. It also uses the Global Reporting Initiative (GRI) standards and the International Integrated Reporting Council Framework to report on material environmental, social and governance activities, and to provide a balanced view of performance.

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Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	A	See below.
Director share ownership	R	See below.
Executive Remuneration	G	See below.
Golden parachutes/handshakes	A	Not disclosed. NZSA expects full disclosure around whether these are similar payments are offered
Director Independence	G	All Directors are independent.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid. See below.
Independent Advice for the Board	G	See below.

Directors Fees: NZSA notes there is no disclosure as to whether other benefits are available for directors, such as share options, retirement benefits or special exertion payments, although the table showing payments to directors is headed “*Details of the **total** remuneration...*” (emphasis added) implying that none are payable. We note that the [Constitution](#) allows payment of special remuneration “*if it is fair to the company*”.

While a shareholder can infer that no additional benefits are available for Directors, we would expect more explicit disclosure from one of New Zealand’s largest listed entities.

Director Share Ownership: The [Board Charter](#) notes that Directors are expected to accumulate 20,000 shares over their first three years. While NZSA encourages share ownership by independent directors, it does not support compulsion as this reduces the pool of available directors, may compromise independence and removes the ‘market signal’ associated with share purchases.

The timeframe of three years to achieve the target of approximately \$150,000, implies an (approximate) 35% purchase rate, meaning that a board applicant would require existing wealth to serve on the Board. NZSA does not believe that ability is not defined solely by wealth.

Executive Remuneration: The CEO is paid a base salary, a short-term incentive (STI) and a long-term incentive (LTI).

NZSA encourages fulsome disclosure in relation to any incentive payments made to the CEO, including disclosure of measures (or measure ‘groups’), weightings, targets and the level of achievement versus target for each component associated with any awards.

Contact provides thorough disclosure for both STI and LTI awards, according to the NZSA preferred methodology described above – excepting that the level of achievement vs each measure group is not disclosed.

We note with some interest that 50% of the LTI award is based on strategic milestones associated with decarbonisation.

The STI potential is 50% of the base salary in cash and 30% of the base in share options. The LTI potential is 35% of the base. Therefore, the total incentives are 115% of the base. The STI is 74% of total incentives. NZSA prefers a weighting towards LTI to ensure the alignment with the long-term interests of shareholders.

We note that overall, a potential 56% of the total maximum incentive opportunity can be paid by way of performance or deferred share rights. Contact is clear about the dilutionary impact of options in its financial statements.

We appreciate the disclosure of the ratio of CEO remuneration to that of the median employee (29:1) as well as pay-equity disclosures.

Golden Parachutes/Handshakes: In the interests of transparency, NZSA believes there should be explicit disclosure around the severance terms associated with the CEO, including whether specific termination payments are offered.

Board Composition: The company provides a ‘collective’ skills matrix in the Annual Report, although does not break this down to attribute the skill sets of individual Directors to provide assurance for shareholders. In mitigation, we note that the Board skills were independently reviewed by Korn Ferry during 2021.

The company does not participate in the IoD’s “Future Director” programme (or similar) to develop and mentor the next generation of Directors. NZSA expect NZX50 companies to participate as part of a responsibility to develop and mentor the next generation of Directors.

The nature of the company’s board indicates a commitment to thought, experiential and social diversity, with relevant experience for Contact.

Director Tenure: NZSA looks for evidence of ongoing succession or ‘staggered’ appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

All Directors have served less than 9 years, with appointment dates ranging from 2015-2021.

Independent Advice for the Board: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

The [Board Charter](#) states that Directors are entitled to seek independent external advice at Contact’s expense, with the prior approval of the Chair. Board members are also able to access internal staff as required. The Board Charter also notes that the General Counsel / Company Secretary has unfettered access to the Board.

Contact offers comprehensive disclosure of the key strategic, climate-related business and financial risks that impact the business, and their mitigations, utilising a ‘materiality matrix’ approach. There is also good disclosure of risk management and governance processes.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure.
Audit rotation	G	See below

Audit Rotation: In August 2022 the company announced EY had been appointed external auditor to replace KPMG who had been the external auditor since 2005.

The company also announced its rotation policy would be 15 years. While NZSA policy is that rotation should be 10 years, we accept the limitations caused by the lack of Audit Firms and suitably qualified Auditors and appreciate Contact's approach as one of the few on the NZX to offer a specific rotation policy in relation to audit firm tenure.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure
Political donations	G	No donations were made.

NZSA notes the comprehensive climate-related disclosures on governance, strategic implications, risk & opportunities and metrics associated with the TCFD (Taskforce on Climate-related Financial Disclosures) framework. This positions Contact well for the emerging regulatory framework currently being formalised by the NZ External Reporting Board. On current XRB Exposure Drafts, we believe that Contact would fully comply with the climate-related disclosure requirement and the expected NZSA *Environmental Sustainability* policy (see below).

The specific, factual disclosures, including measurable outcomes, provide reassurance for shareholders that the company is not 'greenwashing' its stakeholders.

NZSA has released a draft *Environmental Sustainability* policy for consultation, with a broader focus on environmental impacts than climate change. This is expected to be finalised in October 2022, for application from January 2023. We are currently reviewing existing corporate disclosures.

Financial & Performance

Policy Theme	Assessment	Notes
Dividends and Imputation	G	Good disclosure.

Policy Theme	Assessment	Notes
Capital Raise process	n/a	n/a if no capital raised
Takeover or Scheme	n/a	n/a if no takeover

Contact Energy's share price fell from \$8.07 to \$7.14 (as of 18th October 2022) over the last 12 months – a 12% decline. This compares favourably with the NZX 50 which declined by 17% in the same period. The capitalisation of CEN is \$5.6b placing it 10th out of 130 companies on the NZX by size and makes it a large company.

Metric	2020	2021	2022	Change
Revenue	\$2,073m	\$2,573m	\$2,387m	-7%
EBITDA	\$446m	\$553m	\$537m	-3%
NPAT	\$125m	\$187m	\$182m	-3%
EPS ¹	\$0.174	\$0.241	\$0.233	-3%
PE Ratio	38	34	31	
Capitalisation	\$4.8b	\$6.3b	\$5.6b	-11%
Current Ratio	0.66	0.89	0.73	-18%
Debt Equity	0.87	0.72	0.82	14%
Operating CF	\$341m	\$432m	\$400m	-7%
Operating CF (cps)	\$0.47	\$0.56	\$0.51	-8%
NTA Per Share ¹	\$3.08	\$3.18	\$3.07	-3%
Dividend Per Share ¹	\$0.39	\$0.35	\$0.35	n/c

¹ per share figures based off actual shares at balance date (not weighted average)

Nearly all metrics declined for CEN in FY22, but most only modestly after a stellar increase in 2021. Revenues were down 7% to \$2,387m but still ahead of 2020's \$2,073m. EBITDA was down 3% to \$537m and likewise NPAT was down 3% to \$182m. This places CEN on a high PE of 31. This is in line with the sector where share prices rely more on net cashflows for distribution to shareholders than EPS.

Operating cashflows are a more useful financial metric for a company such as CEN, and these decreased by 7% on the prior year coming in at \$400m. Measured in cents per share this equates to \$0.51. These robust operating cash flows enabled CEN to maintain a dividend of \$0.35. As the dividend is higher than EPS (and thus tax paid) dividends are only partially imputed.

CEN operates a financially sound balance sheet and low levels of debt, with debt equity a low 0.82. During the year CEN increased its long-term debt by \$119m and this stands at \$812m. Debt is a mix of bank facilities and bonds.

Customer experiences appear to be improving and on [page 8 of the integrated report](#) the company noted that: "We're winning lots of awards for our customer service excellence too – including Energy Retailer of the Year at the New Zealand Energy Excellence Awards, and four awards at the NZ Compare Awards -awards that our team can feel very proud of."

On page [37 of an investor presentation](#) to market released on 15th August 2021, CEN provide some forward guidance for FY23 on a variety of financial metrics, however do not provide a NPAT range.

Resolutions

1. To re-elect Elena Trout as an Independent Director.

Elena Trout was appointed to the Board in October 2016. She is Chair of the Energy Efficiency and Conservation Authority and a Director of Harrison Grierson Holdings Limited, Ngāpuhi Asset Holdings Company Limited, City Care Limited, Ara Ake and Callaghan Innovation. Her former directorships include the Electricity Authority, Marsden Maritime Holdings Limited and Transpower New Zealand Limited.

We will vote undirected proxies **IN FAVOUR** of this resolution.

2. That the Board is authorised to fix the auditor's remuneration for the coming year.

This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

Proxies

You can vote online or appoint a proxy at <https://www.vote.linkmarketservices.com/CEN/>

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **10.00am Monday 14 November 2022.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA