

Introduction

The purpose of this report is to analyse the 2013 annual report of Mighty River Power (MRP) in order to make a recommendation for Mereana regarding her potential investment of \$10,000. Mereana is looking for an ethical business that will generate a significant long term return on her investment to supplement her retirement fund

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Student 1: Low Excellence
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Brief history of Mighty River Power omitted.

Based on the analysis that follows, my recommendation is that Mereana invest \$10,000 in shares in Mighty River Power.

Profitability

Several profitability paragraphs omitted. The following paragraphs typify the nature of the content.

With the completion of the new geothermic station, Ngatamariki, it is assumed that the net profit will stabilise/increase in coming years. MRP has described it as meaning “greater earnings surety under most market conditions, including weak Waikato hydro conditions”. Not only is geothermic power not susceptible to uncontrollable forces such as the weather, it also has lower operating costs. Therefore, up to 40% of power MRP generates will decrease expenses and provide continuous power generation regardless of the weather. Combined, this will sustainably decrease expenses, increasing profit in the long run. This means that Mereana’s investment would be secure, but also, the higher the profit, the more dividends will be paid to shareholders and her gross dividend yield will increase. This also meets Mereana’s requirement for an ethically sound business as MRP obviously has a significant long-term consideration for preserving the environment and natural resources. MRP’s expense percentage has increased from 2012 to 2013, from 70c of expenses per \$1 of sales, to 72c of expenses per \$1 of sales. This is consistent with the increase in net profit, however can be explained because of the \$97.9m in sales ...

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If net profit was to decrease, this would reduce the amount of dividends paid to shareholders and decrease the value of Mereana’s investment overall. However, as MRP provides 17% of New Zealand’s electricity, it is unlikely that a drop in sales will be significant enough to seriously affect Mereana’s investment. According to the annual report, the “small drop off in residential demand is consistent with the picture nationally”. Profitability is important to Mereana, as that is what both her income stream (dividends) and the increasing value of her investment is dependent on. If MRP’s financial position weakens significantly or long-term, then the value of her investment will not meet Mereana’s purpose of supplementing her Kiwisaver. She could potentially make a loss over the intended 25 years of investment. ... The only change in demand may be an increase in sales during winter (due to heating etc). This would provide relative security for Mereana’s investment compared to investing in other industries.

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Liquidity

Cash Management

These sections, not affecting the student’s grade, have been omitted from this exemplar.

Mereana’s main consideration, aside from financial, is that her chosen investment has ethical business practices. MRP could be considered ethical on the grounds that they have a great environmental concern. Most of their power is generated from hydro, secondly geothermic, with only 7% being generated from gas. In recent years, they have invested \$1.4 billion in geothermal energy, which is seen as an ‘investment’ in sustainability.

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While methods of fuel generation such as hydro and geothermic are considered more environmentally friendly compared to gas based generators, there are concerns regarding the land and resources used to generate this fuel. As Mereana’s investment is long term, the long-term consideration for alternative geothermic energy suggests that MRP plans to remain sustainable while also being profitable, allowing Mereana to maintain/increase her income stream and investment over time.

MRP could also be considered ethical, based on the increase in the health and safety of employees. Large construction projects such as Ngatamariki, highlight the way in which the company manages the health and safety of its employees. The 17% reduction in the Total Recordable Injury Frequency Rate (TRIFR) of the most recent project, from 3.54 to 0.98, shows that MRP is being ethical in terms of making a conscious effort to enhance the health and safety of their employees.

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MRP also plays an active role in the local community, through such means as raising \$1m for Starship Children’s Hospital in the past year.

MRP (and related companies) have developed a variety of programmes and services to make customer experiences as user friendly as possible, to “improve customer satisfaction and loyalty”. This is done with the intention of maintaining and increasing customers and therefore revenue, to improve profits long term. These include:

- Mercury Energy’s ‘good energy monitor’, an online service that monitors how much power the consumer uses to help reduce power consumption (environmental factors).
- Glo-Bug – an energy prepay service, “energy management, cost effective and help to be sustainable”. MRP claims that consumers who use this service pay less for their power and save energy at the same time, as well as “a significant reduction in the number of disconnections ...”

Both of these services are considered ethical as ... [detail omitted from this exemplar]

Dividends

The final dividend for 2013 was declared at 7.2c per share, amounting to total dividends of 12c per share in 2013. ... According to NZX markets, the gross dividend yield of MRP is 7.298%, the highest rate of return out of New Zealand's main power generators - 0% for Meridian and Genesis, 6.256% for Contact Energy and 7.107% for Trust Power. For her \$10,000 Mereana could purchase 4,237 shares (\$2.360 as at 28.7.14), therefore she would have received a total of \$508.44 of dividends in 2013. In order to be able to declare dividends, MRP must pass a solvency test ... MRP has obviously passed both tests in order to be able to issue shares, especially of a value of \$168 million. The test is conducted in order to ensure that companies have the ability to repay their debts and have a stable financial position. As MRP issues dividends, this highlights their stability as a going concern, and therefore the stability of Mereana's potential investment, while suggesting an ongoing annual return.

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Conclusion

Based on MRP's 2013 financial year, it would appear that they have a strong financial position and cash management. Enough so for Mereana to be confident enough that they will remain profitable and liquid, securing and increasing the value of her investment and income stream in the long run. While it is not crucial to her, the dividends that she will receive in the short run may aid Mereana in terms of day-to-day expenses, or provide her with a little bit extra to treat herself or her family.

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As a result of recent political interference through asset sales in New Zealand, investors are being cautious. There is low demand, especially for power generating companies, therefore the share price is relatively low. Once the uncertainty has settled, the share market and value should stabilise/increase. In the case of MRP, they have identified this issue and taken relevant measures, such as the share buyback scheme, to ensure the loyalty and value of shareholders' investments.

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Genesis Energy is due to go on the market soon at a relatively low price of \$1.55, which is another potential option for Mereana. However, Genesis Energy is nowhere near as environmentally friendly (ethical) as MRP as their main production comes from gas/coal generation from Huntly Power Station.

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MRP has recently undergone a share 'buyback' scheme in which the company will repurchase \$50m worth of shares. This is a common practice used by companies in the past to increase the share price and therefore benefit shareholders. The trading price of MRP shares has fallen from their initial selling price of \$2.50 at their issue in 2013, therefore this is a way of potentially appeasing shareholders, by increasing the value of their shares, to maintain investors. This is good for Mereana, as if she were to purchase shares at the current market value (\$2.360 as at 28.7.14) the value of her investment would increase as a result of the buyback scheme.

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Mereana should invest her \$10,000 in Mighty River Power shares as they provide a relatively secure investment in an industry that will not be negatively affected by consumer demand (electricity is an ongoing and increasing necessity). MRP also satisfies Mereana's non-financial requirement for a potential investment as they are ethical by being environmentally and morally sound. Their long-term consideration is not only for the financial position of their business, but for New Zealand's resources and environment.

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MRP is in a strong financial position, and although it is not her primary purpose in investing, will generate Mereana an annual return through dividends. Although nobody can predict the future, it is likely that Mereana's investment will increase in the long run, through initiatives such as the long-term investment in geothermic power generation. This capital gain on the value of her shares suits her purpose of receiving a long-term return to supplement her retirement in 25 years.

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Limitations

A limitation of the report I have prepared for Mereana is that the annual report was published in October 2013 and covered the year ended 30 June, therefore the information is slightly out-of-date. More current information would provide more accurate findings and more certainty around economic forecasts. I would also caution Mereana that I am a student of Level 3 NCEA Accounting rather than a qualified accountant, therefore my interpretation of the MRP annual report and other information about the company may not be as sophisticated as it could be if I were more qualified.

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All sources cited and a bibliography provided.