

Analysis of annual report of Meridian Energy Limited for 2018

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ABSTRACT. *To analyse the annual report of Meridian Energy Limited (MEZ) in 2018 (i.e. the financial report, director's report and auditor's report), identify the particular information provided to satisfy the various disclosure requirements contained in the Corporations Act 2001 and the AASB accounting standards. Most importantly, this article analyses this information from the perspective of the users of accounting information.*

Keywords: *financial report, director's report, auditor's report*

1. Introduction

Meridian Energy Limited (MEZ), which is listed on the Australia Securities Exchange (ASX), is an electricity company. This company generates and provides electricity to customers including homes, business and farms in New Zealand and Australia. MEZ operates seven hydro stations and ten wind farms in New Zealand and Australia. This report, which will be divided into director's report, financial report and auditor's report, focuses on analysing MEZ.

2. Director's report

2.1 General information

Based on Corporations Act 2001 S299, the general information about operations and activities of the directors' report include six disclosure requirements during the fiscal year.

2.1.1 Overview of reviews and operations

According to Corporations Act 2001 S299(1)(a), MEZ needs to review operations during the year. This year (2018), the operational results are better. The \$2762 million revenue of 2018 increased by 19%. Net profit from ordinary activities and net profit after tax increased from 1% to 2%, which is good news for investors compared to the negative profit average across the industry.

2.1.2 Significant changes

Corporations Act 2001 S299(1)(b) demonstrates that any significant change needs to be proven in the directors' report. Firstly, the director retired last year (2017). Neal Barclay, the new Chief Executive, is highly experienced in all areas of the business. Julian Smith has been appointed as Chief Customer Officer, and is familiar with customer sales, service and operations. MEZ will likely have better development with the professional management provided by these directors.

Secondly, MEZ has not completed a full revaluation of the asset class in 2018. Decided by the board, an ultimate valuation range will be determined by an independent valuer. Investors should consider the influence of the full revaluation result.

Finally, GSP Energy Pty Limited was acquired by MEZ leading to a larger market share in the Australian energy market. For investors, this is a positive signal.

2.1.3 Principal activities

The major principal activities MEZ mentioned in the report are the development of retailing and trading of electricity and the sale of complementary products and services. Users can forecast future development with the report.

2.1.4 Matters which has significant effects

The Corporations Act 2001 S299(1)(d) demonstrates that the director's report needs to provide details of matters which have significant effects. Firstly, the accounting policy has been changed, in relation to the treatment of incentives given to customers. The fully retrospective transitional approach is used to deal with this change. However, this does not affect customers.

Secondly, the weather dramatically changed which changed the price and quantity of electricity. The price increased in Q1 with a negative effect on the cost to supply physical and financial electricity sales. The quantity increased in Q3 and Q4 due to the improved hydro storage. The users should consider these internal and external changes when making decisions.

2.1.5 Likely future development

Base on the Corporations Act 2001 S299(1)(e), MEZ discloses likely future development and expected results for a future period. The goal of MEZ is to expand in trading and retailing industry by increasing the sale of electricity and complementary products. By this way, MEZ can achieve this goal and protect the retail industry, increase sales and become more competitive in the oversea market. Users should pay more attention to the news that affects the electricity market when making a decision.

2.1.6 Environmental regulations.

In response to the Corporations Act 2001 S299(1)(f), MEZ discloses that their purpose is to develop sustainable energy and make contribution to achieving zero carbon and reduce climate change risks. As an energy company, MEZ shows a great

attitude to be environmentally-friendly and develop clean energy. However, this also means potential future expense.

2.2 Specific information

In response to the requirement of Corporations ACT 2001 s300(1), the annual director's report should include details of dividends or distributions paid to members, directors, options and unissued shares, director's interest in shares, remunerations and other financial endeavours.

2.2.1 Directors

In response to the Corporations ACT 2001 s300(c) and s300(10)(a), MEZ discloses the name, registered scheme or disclosing entity of the company directors. There are eight directors: Mark Cairns, Jan Dawson, Mary Devine, Anake Goodall, Chris Moller, Steve Reindle, Peter Wilson and Mark Vebiest. All eight directors are experienced and have previous experience as directors in several similar roles, which could significantly benefit the company. The secretary, Jason Stein is also disclosed according to s300(10)(d).

2.2.2 Dividends

With the requirement from Corporations ACT 2001 s300(1)(a), MEZ provides divided ends and distributions paid to the members during the year. The total dividends declared in 2018 is \$486 million (19.2 cents per share), increasing by 1.5% from \$477 million (18.91 cents per share) in 2017. This includes 74.5% of ordinary dividends, increasing by 7% from 14.03 cents to 14.32 cents, and 25.5% of capital management special dividends, with the amount of 62.5 million (4.88 cents per share).

In the last five years, the total dividends declared show a steady upward trend and arrived at 19.20 cents in 2018, which is a positive signal for investors in the short term. In the long term, according to the industry life cycle, with the growth of MEZ, dividends declared should be more static, so shareholders should not expect too much growth.

2.2.3 Share options, unissued shares and directors' interest in shares

In response to the Corporations ACT 2001 s300(1), options and unissued shares should be provided. For MEZ there was no options or unissued shares granted to directors as remunerations. Moreover, in compliance with the directives of s300(10)(a), as a public company, MEZ also represents the relevant interest in shares of each director. Mark Cairns holds the largest amounts of shares between directors, at 200,000. Next is Peter Wilson who holds 99,170. Third is Chris Moller, with 92,880 shares. For the other directors, Jan Dawson has 51,300 shares, Mary Devine is 51,510, Anake Goodall holds 60,000, Steve Reindle has 51,300, and Mark Vebiest has 35,000.

2.2.4 Remunerations Report

According to the Corporations ACT 2001 s300 and AASB 124, the company provides the information about the types of remuneration and key management personnel compensation. There are four types of remuneration for employees: fixed remuneration, short term incentive, long term incentive and employee share ownership. Fixed remuneration consists of a base salary and matching contributions. Variable remuneration includes short term incentives and long-term incentives. Employee share ownership is optional for employees and 50% of the employees participate in this plan. In total, 395 employees receive more than \$100,000 in remunerations during the year, which might be a great attraction for future employees. In addition, with stable cash flow for employee benefit, the company shows the potential ability for future development.

For the chief executive remuneration, Neal Barclay got a total remuneration of \$908,443, including 52% of the fixed remuneration, 18% of short-term incentive and 30% of long-term incentive. The reason that Neal Barclay got the lowest remuneration in the last five year is that he was only paid for his six-month basic salary since becoming the CEO. Since he only worked as CEO for half a year, it is not proper for investors to compare the CEO performance between 2017 and 2018. They may need more time to evaluate the performance of Neal Barclay.

3. Financial Report

3.1 Financial statement

As a parent company which controls many subsidiaries, MEZ prepares consolidated financial statements in response to AASB 10 paragraph 19.

3.1.1 Income

MEZ disclosed the income from 2017 to 2018. The amount of income increased from 2,320 million to 2,762 million between 2017 and 2018. According to AASB118, revenue is recognised when the service is rendered. The operating income included electricity sales to customers, electricity generation-net of hedging, electricity-related services revenue and certain other revenues. During these kinds of income, the revenue of electricity sales to customers and electricity generation had more significant change. First of all, the amount of the electricity sales to customers increased from 1,526 million to 1,652 million. This revenue is influenced by customer contract sales price and their demand for electricity. From 2017 to 2018, with discounts and credits given to customers and the increase in customers' demand for electricity, the income of electricity sales to customers was increased. Additionally, the amount of revenue in electricity generation-net of hedging increased from 775 million to 1088 million. This revenue is influenced by the quantity of generation and the wholesale spot price and is recognised at the time of generation or hedge settlement. Between 2017 and 2018, due to an increase in the quantity of electricity generation, the revenue of electricity generation-net of hedging increased. Therefore, the whole revenue of MEZ increased by roughly 20%. Compared with competitors, this is a great performance. For investors, this is a

positive signal to increase investment.

3.1.2 Expenses

MEZ disclosed the expenses between 2017 and 2018. The amount of expenses increased from 1,663 million to 2,096 million. The expense included electricity expenses-net of hedging, electricity distribution expenses, electricity transmission expenses, employee expenses, electricity metering expenses and other certain electrical expenses. The electricity expense-net of hedging and the electricity distribution expenses had a clearly increasing trend. First of all, from 2017 to 2018, the expenses of electricity increased from 772 million to 1,160 million. This expense is influenced by the quantity and timing of customer consumption and the wholesale spot price. Between 2017 and 2018, due to the increased quantity and timing of customer consumption and the increased wholesale spot price, the electricity expense dramatically increased. Moreover, between 2017 and 2018, electricity distribution expenses increased from 515 million to 550 million. Due to the increased cost of transporting electricity, the electricity distribution expenses increased. Therefore, the total expenses of MEZ dramatically increased by about 26%. For investors, the increasing expense may lead to less profit in the short run, but the potential future benefit should be considered as well.

3.1.3 Taxation

According to the AASB 112 Income Taxes paragraphs 79 to 88, the company disclosed income tax expense of \$9,500,000 in 2018. First of all, the company faced a tax loss during the financial year because the income tax expense increased from 81 million to 95 million between 2017 and 2018. Additionally, the company disclosed the deferred tax assets and deferred tax liabilities. The deferred tax liabilities decreased from 1,715 million to 1,683 million from 2017 to 2018, and it indicated that MEZ will face relatively less pressure on deferred tax liabilities in the future. Moreover, the deferred tax assets increased from 43 million to 46 million, which meant that in the future, the company will have more benefits on tax assets and will reduce the pressure of paying tax.

3.1.4 Property, plant and equipment

According to the disclosure of AASB 116 paragraph 71, MEZ discloses that the measurement base for generation structures and plant assets (land and buildings) are their fair value, while for other property, plants and equipment are valued at historical cost (paragraph71(a)). The accumulated depreciation is 86 million in year 2018 (paragraph71(d)). The depreciation of property, plant and equipment assets is calculated on a straight-line basis with an estimated useful life. (paragraph71(b)(c)). The net growth resulting from revaluation is \$199 million due to an increase of \$308 million in the revaluation reserve and a \$2 million reversal of a previous impairment of assets recognised in the income statement (paragraph71(e)).

Compared with the year 2017, the carrying amount of property, plant and equipment has decreased from 7,961 million to 7,941 million. The main reason is that there is a purchase of subsidiary, which led to a large depreciation expense. This is good news for investors, because the acquisition of GSP energy Pty means the

company is expanding the business and has more market share.

3.1.5 Share capital, EPS, Dividends.

In response to the disclosure requirement of paragraph 106-110 of AASB 101, MEZ issued 2,562,439,404 shares, which increased slightly compared with 2017. The difference is caused by the treasury share movements, which relates to the purchase of shares by participants and the held trust as part of a long-term, equity-settled incentive plan. According to AASB 133 parameter 32, the income statement shows that basic and diluted EPS is \$7.80, which is the same as 2017. Therefore, it can be concluded that in recent years the share capital structure is quite stable, which could also be good news for investors because, with the growing performance of the company and similar number of shares, the dividend payment will be stable.

In response to AASB 10 three types of reserve is represented, including capital share, retained earnings and other reserve. The retained earnings increased by 40% from \$725 million to \$1,010 million leading to the decrease of total equity from \$4,823 million to \$5,090 million. Furthermore, other reserve rose from \$4,222 million to \$4,235 million. The possible reason is that the company might have needed more capital for further development focusing on renewable energy. For investors this is not bad for two reasons. Firstly, the dividend payment shows an increased trend from \$477 million to \$486 million, which shows a stable growing dividend revenue. Secondly, as the renewable and sustainable energy is a global hotspot and a future trend, the money invested for renewable energy might bring long term revenue for investors.

3.1.6 Intangible assets

The main section of intangible assets is the computer software and its licenses, which is amortised through a straight-line method, with an estimated useful life up to 10 years (AASB 138 paragraph 118). The carrying amount is also disclosed, which is \$60 million, similar to \$58 million in 2017. As an energy company, a stable carrying amount of intangible assets is common because it is mainly consisting of the software and ERP platform. There is no goodwill shown in the report.

3.1.7 Lease

According to the disclosure requirement in AASB 117, MEZ disclosed the financial lease in the section C8 of the financial statement. In response to paragraph 31(b) of AASB 117, MEZ has demonstrated the lease in three parts, including a lease not later than one year, a lease later than one year and not later than five years, and a lease later than five years. Finance lease payables are classified as financial liabilities at amortised cost. The minimum lease payments of 2018 were 48 million dollars, which included 7 million dollars which should be paid in one year. Investors may consider the ability to pay off a lease payment. However, there are 427 million dollars of operating cash flow, which can cover the 7 million dollars payable. Thus, the future payment of the lease may not be a risk for MEZ.

3.1.8 Related party transactions

According to paragraph 9 of AASB 124/IAS 24, MEZ discloses related party

transactions in note F2, which covers a variety of services including trading energy, transmission, postal, travel and tax.

Moreover, in response to the requirement in paragraph 17 of AASB 124/IAS 24, MEZ disclosed 7 million dollars of salaries and short-term benefits in 2018, which increased by 16.67% compared to 2017. That activity may result in the increase of employee productivity.

Additionally, there are 1 million dollars of long-term benefits in 2018, which is a decrease from 2 million in 2017. This means there were no long-term employee benefits added this year. On the one hand, less was spent on employee benefit, on the other hand, shareholders should consider its negative effect on the employee productivity.

3.1.9 Contingent assets and liability

According to AASB 137, MEZ discloses contingent assets and liability. As a part of the contingent liability, MEZ discloses that it has given bank guarantees of 38 million dollars and provided parent guarantees of 33 million dollars, respectively. The manager of MEZ cannot confirm whether the payment occurred or not. Because the contingent liabilities were a possible obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, investors need to consider that the contingent liabilities may increase the future risk of MEZ.

3.1.10 Business combinations

The paragraph 59 (a) of AASB 3 demonstrate that MEZ shall disclose information that enables users of its financial statements and investor to evaluate the nature and financial effect of a business combination during the current reporting period. GSP Energy Pty Limited was acquired by MEZ for 182 million dollars with 100 percent of the shares. The consideration transferred is equal to the net asset, which means there is no goodwill or gain on bargain in this acquisition. Three hydro power stations were purchased by MEZ, which supports future Australian customer growth. With this subsidiary, MEZ can expand market shares in Australia, which may lead to more investing of cash outflow but it is still a positive signal to investors.

3.2 Financial Ratio Analysis

Table Financial Ratios of MEZ and Industry Average in Recent 5 Years

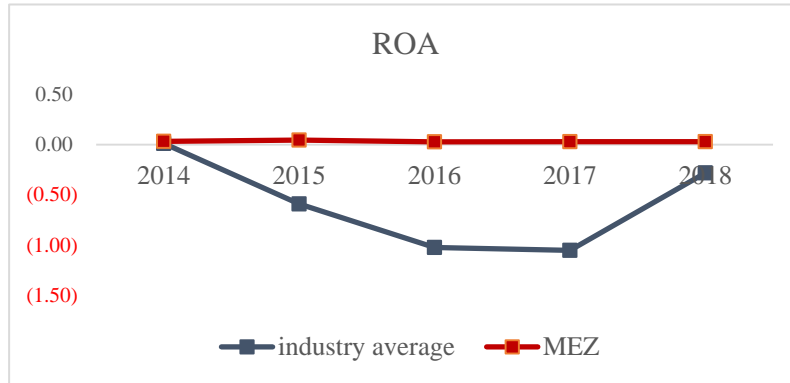
ratio		2014	2015	2016	2017	2018	5-year average
current ratio	industry average	2.44	2.25	2.20	2.20	1.65	2.15
	MEZ	1.12	0.70	0.79	0.74	0.53	0.78
financial leverage	industry average	2.46	2.73	2.46	3.83	2.43	2.79
	MEZ	1.64	1.61	1.69	1.71	1.79	1.69
ROA	industry average	0.01	(0.59)	(1.03)	(1.05)	(0.28)	(0.59)
	MEZ	0.03	0.05	0.03	0.03	0.03	0.03
EPS	industry average	-0.17	7.57	2.01	7.68	11.61	5.74
	MEZ	8.68	8.53	6.88	7.32	7.19	7.72
Net profit margin	industry average	(2.99)	0.05	(3.11)	(1.85)	(3.15)	(2.21)
	MEZ	0.08	0.10	0.08	0.09	0.07	0.08
payout ratio	industry average	0.99	2.57	2.03	0.95	1.29	1.57
	MEZ	1.70	1.71	2.54	2.26	2.45	2.13

Through comparing financial ratios of different years, investor and the internal company managers can have a clear understanding of the company. Moreover, managers usually use these ratios to assess the performance and chance of improvement of the company (Achim, Borlea, & Gaban). The above table demonstrates the financial ratio.

3.2.1 Profitability Analysis

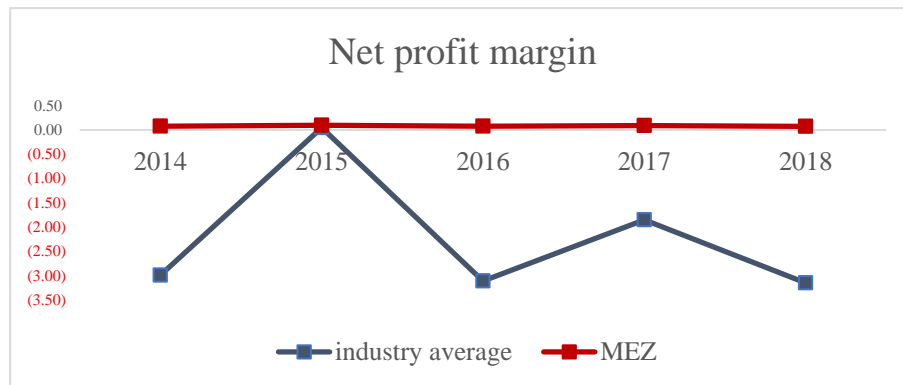
(1)ROA. Profitability is a major factor for investors to judge whether the company is worth investing. The most important thing is that outstanding profitability can indicate the company has the ability to achieve profit and undertake less risk in the future by analyzing return on asset (ROA) and the net profit margin. In this report, MEZ had great future potential growth on profitability compared with the rest of the Australian electricity industry. In recent years, the Australian electricity industry had a decreased trend on profit (Nelson, Bashir, McCracken-Hewson, & Pierce, 2017). However, MEZ is a special example. First of all, ROA had a stable trend compared with the industry average. It indicated that MEZ earned a return effectively on its investment in assets. For example, its rate of return on total assets is high to 0.03 and more than the industry average (-0.28) in 2018. Compared with the rate of ROA in 2017, the figure was still 0.03, which means that the ROA always had a relatively stable trend. Thus, investors can use this rate to analyse the operating of MEZ and the better operating future will be achieved through analysing this rate.

Char Comparison of ROA between MEZ and Industry Average



(2) Net profit margin. Moreover, the net profit margin is also a significant indicator in order to analyse profitability. This rate also had a stable trend by comparing with industry average. For instance, the rate of net profit margin is 0.07 in 2018, but the industry average rate is only -3.15. This means that MEZ has an expected profitability in its future. To improve the ability of earning profit, MEZ should extend their marketing area, increase sales revenue and decrease expense. Marketing orientation is a major part of improving the profitability. MEZ should continue extending their marketing area. Therefore, investors can convince that MEZ has an outstanding financial position in the future and they can have investment in MEZ.

Chart: Comparison of Net Profit Margin between MEZ and Industry Average

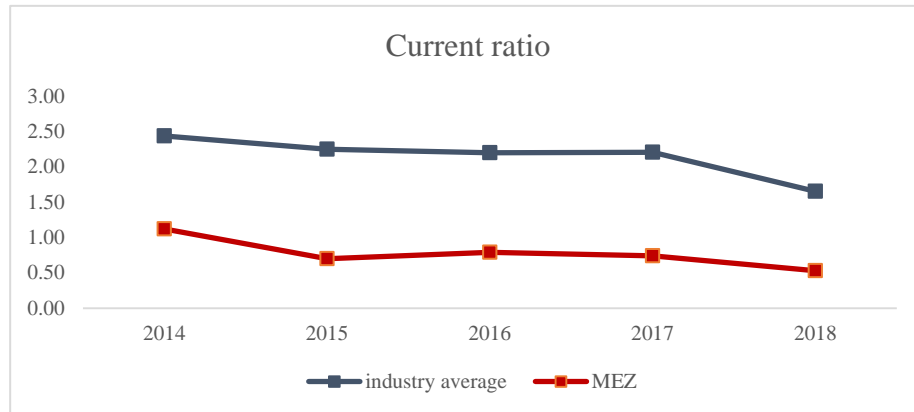


3.2.2 Liquidity Analysis

(1) Current ratio. As shown in the table of a financial ratio, the current ratio is 0.53 in 2018, which decreased from 0.74 in 2017. Moreover, the ratio of most industries is 1.65 in 2018, the acceptable norm of the current ratio for MEZ is lower than the industry. It is a signal that MEZ has a weak ability to repay short-term debt. The main reason for the decrement of the current ratio of MEZ is the increase of current liability. According to note C7, the current portion of the term borrowings has an increment from 2017 to 2018. For the investor, the ability to repay the current

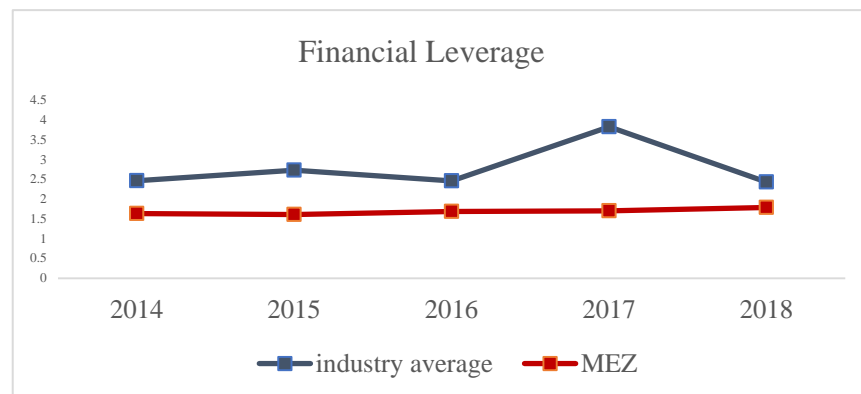
debt of MEZ might not be enough.

Chart: Comparison of Current Ratio between MEZ and Industry Average



(2) Financial leverage. According to the table of financial ratio, the financial leverage of MEZ is 1.79 in 2018, as well as 2.43 for most industries. This signals an advantage that the risk of failure is lower than in most industries. However, according to Kizildag and Ozdemir (2017), the lower ratio of financial leverage might mean a poorer of lending capacity. Additionally, the financial leverage of MEZ has an increment in the past five years. The main reason is the increment of total liability. The rise of financial leverage can lead to the risk of repay debt. Thus, although there is now an optimal condition, the investors may consider a lower ability to repay the MEZ debt in the future.

Chart: Comparison of Financial Leverage between MEZ and Industry Average



3.2.3 Capital market Analysis

(1) Earning per share. Comparing the EPS of MEZ with the industry average in recent five years, it can be seen that the earning per share of MEZ is over the industry average in recent years, except for 2018. This is consistent with the shares

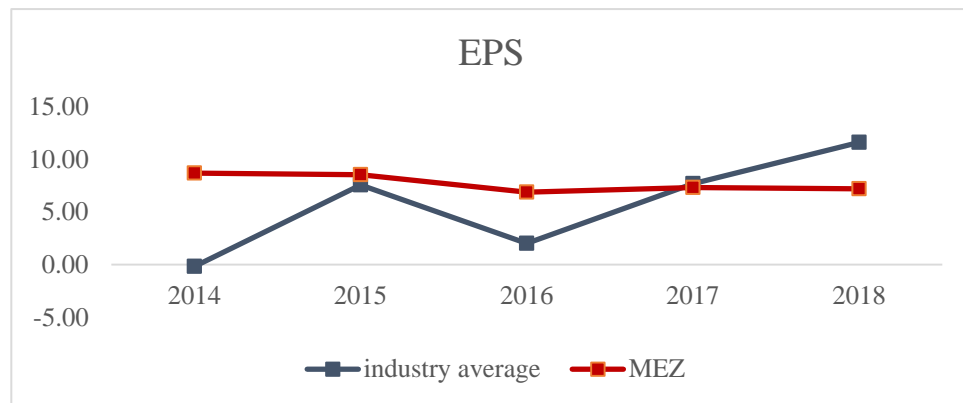
price, which shows steadily increases in recent five years. The growing share prices and stable dividend payout amount contributes largely to the great performance of EPS. Although it falls below industry average in 2018, there is not much to be concerned about as the EPS steadily moves towards \$10. For investors, the future expectation for EPS might not increase rapidly but it would also not dramatically decrease.

Chart: share price of MEZ from 2016 to 2019



Sources: Australian Securities Exchange, <https://www.asx.com.au>

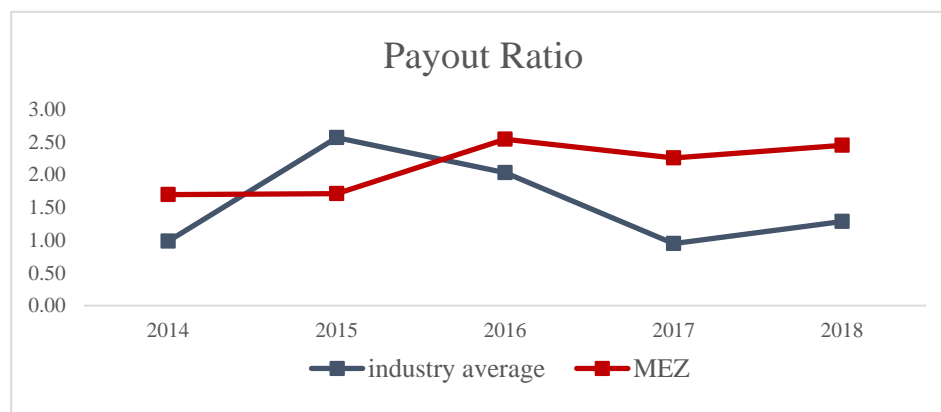
Chart: Comparison of EPS between MEZ and Industry Average



(2) Payout ratio. The payout ratio of MEZ is 2.5 this year, which is much higher than the industry average. As the chart below illustrates, the dividend payout ratio keeps increasing in the last 5 years and crossed the industry average in 2016. This is consistent with the growing dividend payout amount. As the dividend payout ratio is stable and higher than industry average, shareholders might expect a positive and stable dividend declared in the coming years. However, for the company, there is a significant relationship between profitability and the dividend payout ratio (Hasan, Ahmad, Rafiq, & Ur Rehman). If the dividend payout ratio is too high, there might not be much remaining for retained earnings and future development and this may affect the profitability. Therefore, the investors should pay attention to whether the

company controls the payout ratio at a proper level.

Chart: Comparison of Payout ratio between MEZ and Industry Average



4. Auditor's report

According to s307 under Corporation Act 2001, the claim of the independence of the auditor should contain one main section. This should be that the auditor has no contraventions of both independent requirements and the professional conduct from the relevant section. For MEZ, the above requirement of the declaration in the auditor's independence has been achieved. Furthermore, in Section 308 of the Corporation Act 2001, compliance with accounting standards and true and fair view in financial position is required to be disclosed in the auditor's claim. As the financial report is based on AASB and corporations Regulation 2001, it indicates that the financial report provides truth and fairness of the company's financial position. In additions, the auditor's responsibility is also under these standards. Therefore, the financial report is reliable and can be used as an important reference for investors to make significant decisions.

5. Conclusion

In conclusion, MEZ has had a relatively stable financial position in recent years. According to AASB and corporation Act (2001), MEZ disclosed all the requirements of materials. All information is true and fair. In response to the standard, the annual report in 2018 is also true and fair. Investors and managers can use this report to analyse the operating of MEZ and make their decisions. Particularly in 2018, MEZ had good profitability, and investors with investment in MEZ could acquire profit. However, the ability of using assets is at a relatively low level. MEZ should improve this problem to obtain a better financial future. Overall, MEZ has a desirable profitably and a stable financial position.

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Ratio	Calculation
Current ratio	Current assets/current liability
Financial leverage	Total liability/ total equity
EPS	Earnings per share
Profit margin	Net income/ net sales
Dividend payout ratio	Dividends/ net income