VM Wealth Management Limited

Company Analysis: Wigton Windfarm Limited (WIG) FY 2023

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Wigton WINDFARM LTD

- Recommendation: **OVERWEIGHT**
- Current Target: $1.13
- Target Price: **$1.26**

- Shares Outstanding: 11,000,000,000 units.
- Financial Year End: March 31

ABOUT THE COMPANY

Wigton Windfarm Limited (WIG) stands as the largest windfarm across the English-speaking Caribbean, currently managing 44 wind turbines situated in Rose Hill, South Manchester, Jamaica. Established on April 13, 2000, WIG initially operated as a subsidiary of the state-owned Petroleum Corporation of Jamaica (PCJ) before its divestment to the public in 2019. In the same year, the Company successfully refinanced US$49 million of its debts through a private placement, marking a notable reduction of approximately one-third in its finance costs.

The Company's expansion unfolded in three distinct phases: Wigton I, II, and III, executed in 2004, 2010, and 2016, respectively. Wigton phase I yielded an energy output of 20.7MW at a cost of US$26 million, while phase II generated 18MW at a cost of US$47.5 million. Phase III, costing US$47 million, contributed 24MW, consequently elevating the company's overall output to 62.7MW. This energy is channeled to the Jamaica Public Service Company (JPS).

WIG employs a special share arrangement, imposing a "lock-in" provision that restricts any individual or entity from holding more than 10% of the company for a designated 5-year period. This arrangement commenced on May 1, 2019, and is slated to expire on May 1, 2024.

FINANCIAL PERFORMANCE

J$'000	FY 2022	FY 2023	9M 2022	9M 2023
Revenue	2,049,232	2,218,435	1,773,247	1,495,818
Operating Profit	877,491	1,065,345	992,359	505,549
Net Profit	437,400	308,645	503,822	490,578
Total Assets	10,941,389	10,975,227	10,744,217	10,307,765
Total Liabilities	6,761,322	6,546,018	5,799,488	5,387,012
Total Equity	4,180,067	4,429,209	4,944,999	4,920,752

Dividend Policy

WIG's dividend policy targets to pay out not exceeding 25% of net profits after tax. Since being listed on the Jamaica Stock Exchange (JSE), WIG has paid out dividends to its shareholders on four occasions, FY 20/21 (27.50 million), FY 21/22 (200.20 million) FY 22/23 (60.50 million) and FY 23/24 (65.37 million). The most recent dividend declaration occurred on January 30,2024 of $0.005943 per share paid on February 27,2024.

Outlook

Wigton is expected to benefit from the Ministry of Science, Energy and Technology's Integrated Resource Plan (IRP) to procure up to 500MW of electrical energy by 2025. Considering this, we anticipate that the demand for renewable energy is likely to increase and the Company is well positioned to take advantage of the growing demand for renewable energy. WIG is currently in talks about the repowering and upgrade of its Phase 1 plant whose agreement with JPS expired in March 2024 to continue to be able to generate more energy more efficiently this will enable the continuity of Phase I. This accompanied with other solar energy initiatives and alternative investment opportunities should allow it to have a great degree of financial flexibility to take on opportunities within the renewable space as they arise.

Projections and Valuations

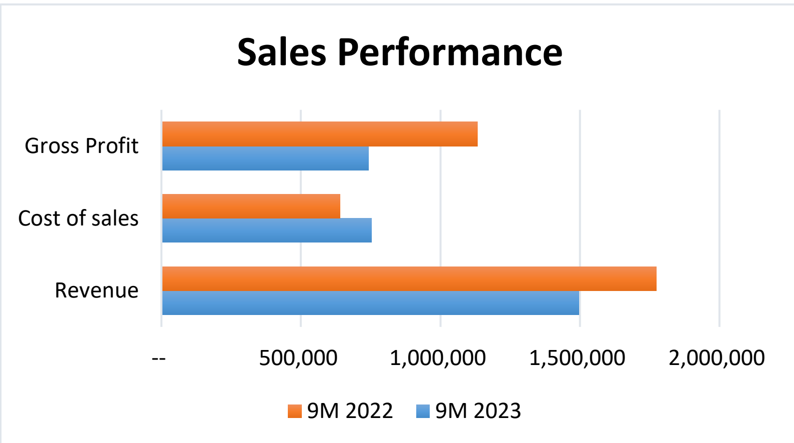
Using the Discounted Cash Flow Model (DCF) valuation method, a target value for WIG was determined. The estimated five-year future levered free cash flows were discounted using a cost of equity of 12.10% and a long-term growth rate of 4.25%. When the appropriate annual discount was applied, we arrived at a target price of $1.28.

Risks to Price Target

The target price for WIG may not be realized if hindered by higher replacement and other equipment costs. Any significant natural disaster or adverse changes in the climate can impede or restrict the flow of wind as well as damage infrastructure at the plant, which is likely to impact the company's performance. Conversely, forthcoming strategic alliances, expanded revenue streams from alternative renewable energy sources and the expiration of the shareholders cap could lead to the price exceeding target.

9 MONTHS ENDED DECEMBER 30, 2023:

WIG's revenues for the 9 months ended December 31, 2023, decreased by 15.65% to $1.50 billion from $1.77 billion recorded during the same period the previous year. This reduction was due to a 17.50% decrease in production, from 117,482,641 kWh to 96,906,839 kWh, as a result of lower plant availability[1] from 91.10% to 91.0% for the current period. The company operates a 100% renewable energy plant and thus revenue is driven by the plants ability to generate energy based on its natural availability.



The reduction in revenue coupled with a 17.69% increase in cost of sales resulted in a 34.38% decline in gross profits from $1.13 billion to $742.45 million.

As a result of the downward pressure on gross profits and a 23.90% rise in general administrative expenses, operating profit registered a 49.06% decline. The decrease from $992.36 million in 2022 to $505.56 million in 2023 was mainly due to higher inflationary adjustments to employee cost, legal and professional fees as well as repairs and maintenance.

Consequentially, profit before taxes dropped to $178.99 million from $662.92 million. This occurred even though finance costs were reduced by 4.39%. However, due to the amendment of the Income Tax Act to promote the expansion of the energy industry, this has resulted in the decrease in the income tax rate from 33 1/3% to 25%. Hence, Wigton only recorded a 2.63% decrease in its Net Profits from $503.82 million (E.P.S. $0.046) to $490.58 million (E.P.S $0.045). The root cause of the fall in profitability was the underperformance in overall sales.

WIG's total assets as of December 31, 2023, decreased to $10.31 billion from $10.74 billion, or by 4.06%. This decline was primarily caused by decreases in the Company's, property, plant, and equipment (PPE), cash and cash equivalents, Investment in associate and pension plan assets, which fell by 7.64%,12.92%,15.65% and 26.67% respectively.

Total Liabilities fell to $5.38 billion from $5.80 billion or by 7.11% this was driven by the 20% reduction in the Company's Long-term liabilities which accounts for 59% of the company's total liabilities . This was due to quarterly principal repayments in respect to Bond A during the period. Bond A is an amortizing Bond, the first quarterly principal payment of $217.00 million was made in June 2022 and Bond B will be repaid at the end of March 2027; interest is paid quarterly in both cases.

Total Equity decreased marginally to $4.92 billion from $4.94 billion or by 0.49%, solely attributed to the decline in Retained Earnings which moved to $4.72 billion from $4.74 billion due to the 2.63% decline in net profit; there were no movements in the company's Share Capital.

WIG's current ratio marginally changed from 4.64x to 4.54x as the growth in current liabilities outpaced the growth in current assets, mainly attributable to increases in accounts payable and the current portion of long-term liabilities. The company's current ratio coupled with its comfortable cash position of $3.52 billion demonstrates its ability to satisfy its short-term obligations adequately.

[1] The term "availability" as used in the wind industry, is a measure of the potential for a wind turbine or wind farm to generate electrical power.

OUTLOOK

INCREASED ENERGY PRODUCTION

The Jamaican government is strongly supportive of clean energy development, including hydroelectric, solar, and wind power. By 2030, renewable energy is mandated to constitute at least 20% of the nation's energy mix, with ambitions to raise this to 50%, as stated by the Prime Minister. This progressive stance bodes well for WIG's expansion plans and its goal of increasing clean energy production. WIG intends to enhance its operations by implementing Phase IV, adding more wind turbines, and expanding its renewable energy presence. The company aims for a 637MW output capacity by 2037, with a target of 56% from wind and solar energy sources. Furthermore, WIG has identified multiple suitable sites for sustainable wind energy projects.

ROAD TO DIVERSIFICATION

Wigton acknowledges the importance of diversification to mitigate revenue risks. To achieve this, the company is venturing into projects involving various renewable energy sources, both independently and in collaboration with others. In March 2022, Wigton acquired a 21% stake in Flash Holdings Limited (FHL), which owns Flash Motors Company Limited (FMCL), a Jamaican distributor of electric vehicles. Additionally, in April 2022, Wigton partnered with Innovative Energy Company DBA IEC SPEI Limited (IEC) to establish the Wigton-IEC Joint Venture, aimed at executing green energy projects within the local market.

This joint venture is currently completing its obligations with the Ministry of Agriculture and Fisheries for the design, supply, and installation of Distributive Solar Photovolatic Systems. Additionally, the company has recently been issued an agreement by MBJ Airports Limited for the design, engineering and installation of roof mounted solar photovoltaic systems. Wigton is also able to submit its bid request to supply 100MW of renewable energy to the national grid by the Generation Procurement Entity of Jamaica. Further revenue diversification strategies are being explored with plans also underway to commercially develop the land the company owns at Ferry Pen, St. Andrew to generate real estate returns.

WIGTON PHASE 1 REPOWERING

The current Power Interchange Agreement between Wigton Phase 1 and the Jamaica Public Service, which facilitated the sale of energy generated from the plant, lapsed in March 2024. Following this expiration, the company has engaged in discussions with stakeholders to ensure the continued operation of the plant through repowering and the installation of newer, more efficient wind turbines. Upon completion of these upgrades, the plant is expected to operate more efficiently, leading to enhanced performance and reduced maintenance costs. This initiative will optimize the company's renewable energy capabilities, fostering more sustainable and environmentally friendly energy production.

INVESTMENT POSITIVES

- Strong government and regulatory support for renewable energy. While renewable output is currently at 15.0% of total electricity generated, the government has an interest in pushing that figure closer to 50.0% by 2030.
- The average availability of energy production is likely to remain above historical norms following the shift to a more profit driven business model following privatization.
- WIG uses data mining technology to help control costs.
- Geopolitical tensions which cause oil price volatility has further incentivized countries to accelerate renewable energy solutions.
- More viable sites across the island for expansion and diversification opportunities to boost overall revenues. The revenue model is also resilient to impact from the COVID-19 pandemic.
- Investors are restricted from owning more than 10% of the shares outstanding for 5 years following the IPO in May 2019. Following this restriction period, the company should be open to investors seeking to take a larger strategic position or do a buyout[1]. This restriction is due to be lifted in May 2024 which could lead to an increase in demand, which bodes well for the stock's performance.
- Since listing on the JSE, WIG has paid annual dividends from FY 20/21 to FY 23/24.

INVESTMENT NEGATIVES

- The wind turbines typically have an operational lifespan of 15-20 years. After this period, the company should be faced with high replacement costs.
- Unpredictability of wind to power turbines directly impacts revenues.
- The company is exposed to termination risks. As the company's turbines may still be functional, there is no automatic right to continue energy production to JPS.
- Natural disasters or any negative climatic shifts may either damage the turbines or impede the flow of wind needed to sustain energy production.
- The company faces competition from other players within the energy landscape, such as Jamaica Energy Partners and Jamaica Private Power Company.

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CONCLUSION

Renewable energy continues to emerge as a more cost-effective option for JPS, surpassing fossil fuel energy in attractiveness, particularly with the volatility in the oil market in the past two years. This aligns with the GOJ's ambition to diversify Jamaica's energy mix, aiming for renewable energy to constitute approximately 56% by 2037. The renewable energy sector thus presents substantial growth prospects. WIG has recognized this and is pursuing revenue diversification plans in solar energy and other renewable solutions, alongside alternative investments like real estate. Repowering Phase 1 of the plant will enhance energy production efficiency and environmental friendliness. Coupled with the expiration of the shareholder cap, these developments are poised to benefit the company.

Our analysis indicates strong cash flows and consistent profitability in the foreseeable future. Using a Discounted Cash Flow method with a cost of equity of 12.10% and a long-term growth rate of 4.25%, we value the company at $1.26, implying a potential 11.69% upside over the current market price of $1.13.

With dividends paid out annually since FY 20/21, investors seeking value may find greater opportunities, as dividend payments are likely to continue. Therefore, we recommend investors with a long-term outlook and an interest in the renewable energy sector to overweight the stock currently.

SOURCES

Bloomberg, The Jamaica Stock Exchange and Wigton Windfarm Limited Quarterly & Annual Reports, The Jamaican Gleaner, Jamaica Information Service (JIS).

DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may