

Genesis Energy

OUTPERFORM

Retail Tracking Well, Generation Less So

We are upgrading our Genesis Energy (GNE) rating to **OUTPERFORM** as we believe recent share price falls are overdone. GNE will be one of the least affected generator/retailers in the unlikely event that NZAS closes.

What's changed?

- **Earnings:** FY20/FY21 EBITDAF -\$2m/+\$4m to \$365m/\$410m
- **Target Price:** Lowered -5cps (-1.3%) to \$3.23
- **Rating:** Upgraded to OUTPERFORM

NZAS risk relatively low for GNE

Compared to 2013, GNE's NZAS closure risks are materially lower. By the time lower South Island transmission constraints are removed (~2024), GNE will have very little contracted take or pay gas. In addition, it has no generation behind the initial lower South Island transmission constraint, so does not face spill risk. That said, we expect NZAS closure would result in GNE closing its Rankine units and running Unit 5 more as a peaking plant earlier than originally planned — there will be some modest costs associated with this. With GNE having a relatively low risk to NZAS closure, we do not expect it will be providing any price support to lower the risk of NZAS closing.

The modest value risks associated with NZAS closing have lowered our target price -5cps (-1.3%, risk weighting of NZAS closing of 20%) to \$3.23.

Mixed 1Q20 operating statistics

On the positive side, retail margins are growing faster at GNE than any other generator/retailer, across all products. However, low cost hydro generation was soft in 1Q20 and thermal generation volumes and costs higher than expected. We estimate that due to the high priced imported coal in the stockpile, the Rankine coal units cost more than \$130/MWh to run in 1Q20, higher than the average generation price received.

Our FY20 EBITDAF forecast is -\$2m lower to \$365m, however, the higher than expected retail margins result in modest earnings growth in FY21 and beyond.

Investment View

Our rating is OUTPERFORM. GNE is trading on the sector leading dividend yield and market multiples. It also has the strongest near-term growth profile, aided by high cost gas contracts rolling off from FY21 onwards. Its downside risks to NZAS closing are also amongst the lowest in the sector.

| NZX Code | GNE |
|------------------------|---------------------|
| Share price | NZ\$3.16 |
| Target price | NZ\$3.23 |
| Risk rating | Low |
| Issued shares | 1029.4m |
| Market cap | NZ\$3,248m |
| Average daily turnover | 494.6k (NZ\$1,541k) |

Share Price Performance



| Financials: June | 19A | 20E | 21E | 22E |
|------------------|-------|-------|-------|-------|
| NPAT* (NZ\$m) | 158.9 | 157.3 | 201.4 | 249.7 |
| EPS* (NZc) | 15.5 | 15.2 | 19.3 | 23.7 |
| EPS growth* (%) | 21.7 | -2.1 | 26.7 | 23.3 |
| DPS (NZc) | 17.1 | 17.4 | 17.7 | 18.0 |
| Imputation (%) | 80 | 90 | 95 | 95 |

| Valuation (x) | 19A | 20E | 21E | 22E |
|--------------------------|------|------|------|------|
| EV/EBITDA | 12.2 | 12.2 | 10.9 | 9.9 |
| EV/EBIT | 26.6 | 28.8 | 22.8 | 20.2 |
| PE | 20.3 | 20.8 | 16.4 | 13.3 |
| Price / NTA | 1.8 | 1.9 | 2.0 | n/a |
| Cash dividend yield (%) | 5.4 | 5.5 | 5.6 | 5.7 |
| Gross dividend yield (%) | 7.1 | 7.4 | 7.7 | 7.8 |

*Historic and forecast numbers based on underlying profits

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Genesis Energy Limited (GNE)

Priced as at 06 Nov 2019: NZ\$3.16

June year end

| Forsyth Barr valuation | | | | | Valuation Ratios | | | | | | |
|--|--------------|------------------|--------------|--------------|-------------------------------|--|--------------|--------------|--------------|--------------|--------------|
| Valuation methodology | | | | | 2018A 2019A 2020E 2021E 2022E | | | | | | |
| Mix of market multiple and DCF | | | | | EV/EBITDA (x) | 12.3 | 12.2 | 12.2 | 10.9 | 9.9 | |
| | | | | | EV/EBIT (x) | 28.8 | 26.6 | 28.9 | 22.8 | 20.3 | |
| | | | | | PE (x) | 24.8 | 20.4 | 20.8 | 16.4 | 13.3 | |
| | | | | | Price/NTA (x) | 2.0 | 1.8 | 1.9 | 2.0 | 2.1 | |
| | | | | | Free cash flow yield (%) | 4.9 | 5.0 | 5.6 | 6.6 | 7.9 | |
| | | | | | Net dividend yield (%) | 5.3 | 5.4 | 5.5 | 5.6 | 5.7 | |
| | | | | | Gross dividend yield (%) | 7.0 | 7.1 | 7.4 | 7.6 | 7.8 | |
| | | | | | Imputation (%) | 80 | 80 | 90 | 95 | 95 | |
| | | | | | Pay-out ratio (%) | 132 | 110 | 114 | 92 | 76 | |
| Key WACC assumptions | | | | | Capital Structure | | | | | | |
| DCF valuation summary (NZ\$m) | | | | | 2018A 2019A 2020E 2021E 2022E | | | | | | |
| Risk free rate | 2.00% | Total firm value | | | 4,299 | Interest cover EBIT (x) | 1.4 | 2.1 | 2.1 | 3.0 | 3.6 |
| Equity beta | 0.88 | (Net debt)/cash | | | (1,255) | Interest cover EBITDA (x) | 4.9 | 5.0 | 5.0 | 6.3 | 7.4 |
| WACC | 6.7% | Value of equity | | | 3,044 | Net debt/ND+E (%) | 37.7 | 35.5 | 37.3 | 36.7 | 35.5 |
| Terminal growth | 1.5% | Shares (m) | | | 1,029 | Net debt/EBITDA (x) | 3.3 | 3.3 | 3.4 | 2.9 | 2.4 |
| Profit and Loss Account (NZ\$m) | | | | | Key Ratios | | | | | | |
| 2018A 2019A 2020E 2021E 2022E | | | | | 2018A 2019A 2020E 2021E 2022E | | | | | | |
| Sales revenue | 2,305 | 2,701 | 2,656 | 2,433 | 2,395 | Return on assets (%) | 2.4 | 3.4 | 3.4 | 4.5 | 5.2 |
| Normalised EBITDA | 361 | 363 | 365 | 410 | 453 | Return on equity (%) | 3.0 | 3.1 | 2.9 | 4.7 | 5.9 |
| Depreciation and amortisation | (206) | (197) | (210) | (214) | (231) | Return on funds employed (%) | 3.6 | 3.6 | 3.4 | 4.4 | 5.2 |
| Normalised EBIT | 155 | 167 | 155 | 196 | 221 | EBITDA margin (%) | 15.6 | 13.5 | 13.7 | 16.8 | 18.9 |
| Net interest | (74) | (73) | (73) | (66) | (61) | EBIT margin (%) | 6.7 | 6.2 | 5.8 | 8.1 | 9.2 |
| Associate income | - | - | - | - | - | Capex to sales (%) | 4.7 | 2.5 | 2.8 | 2.6 | 2.4 |
| Tax | (22) | (27) | (23) | (37) | (45) | Capex to depreciation (%) | 52 | 35 | 35 | 30 | 25 |
| Depreciation capex adjustment | 71 | 92 | 98 | 107 | 134 | | | | | | |
| Adjusted normalised NPAT | 129 | 159 | 157 | 201 | 250 | Operating Performance | | | | | |
| Abnormals/other | (109) | (100) | (98) | (107) | (134) | 2018A 2019A 2020E 2021E 2022E | | | | | |
| Reported NPAT | 20 | 59 | 59 | 94 | 115 | Renewable generation | 3,084 | 2,835 | 2,611 | 2,717 | 2,717 |
| Normalised EPS (cps) | 5.8 | 6.5 | 5.7 | 9.0 | 11.0 | Gas generation | 3,392 | 2,586 | 2,836 | 2,783 | 2,783 |
| DPS (cps) | 16.9 | 17.1 | 17.4 | 17.7 | 18.0 | Coal generation | 657 | 1,410 | 1,121 | 876 | 876 |
| | | | | | | Total GNE generation (GWh) | 7,133 | 6,831 | 6,568 | 6,377 | 6,377 |
| Growth Rates | | | | | 2018A 2019A 2020E 2021E 2022E | | | | | | |
| Revenue (%) | 18.1 | 17.2 | -1.6 | -8.4 | -1.6 | GWAP (\$/MWh) | 92 | 143 | 132 | 108 | 97 |
| EBITDA (%) | 8.4 | 0.8 | 0.4 | 12.3 | 10.5 | Coal used (tonnes) | 348 | 720 | 580 | 453 | 453 |
| EBIT (%) | -2.0 | 7.8 | -7.4 | 27.0 | 12.7 | Coal price (\$/tonne) | 120 | 139 | 142 | 125 | 126 |
| Normalised NPAT (%) | -18.9 | 23.5 | -1.0 | 28.0 | 23.9 | Gas used (PJ) | 26.7 | 20.2 | 21.0 | 20.5 | 20.5 |
| Normalised EPS (%) | -19.6 | 21.7 | -2.1 | 26.7 | 23.3 | Gas price (\$/GJ) | 7.9 | 8.6 | 8.7 | 8.5 | 8.5 |
| DPS (%) | 1.8 | 0.9 | 1.8 | 1.7 | 1.7 | | | | | | |
| Cash Flow (NZ\$m) | | | | | 2018A 2019A 2020E 2021E 2022E | | | | | | |
| EBITDA | 361 | 363 | 365 | 410 | 453 | Electricity customers (000) | 503.7 | 499.5 | 499.5 | 494.5 | 492.0 |
| Working capital change | 33 | (27) | (1) | (12) | (8) | MM/SME volumes | 4,169 | 4,077 | 4,067 | 4,057 | 4,036 |
| Interest & tax paid | (120) | (123) | (109) | (118) | (129) | TOU volumes | 1,811 | 1,992 | 2,061 | 2,082 | 2,102 |
| Other | (7) | 17 | - | - | - | Total fixed price volumes (GWh) | 5,980 | 6,068 | 6,128 | 6,139 | 6,138 |
| Operating cash flow | 266 | 231 | 256 | 280 | 315 | Average MM usage/cust (kWh/yr) | 8,240 | 8,126 | 8,122 | 8,162 | 8,191 |
| Capital expenditure | (108) | (69) | (74) | (64) | (57) | Average FPV price (\$/MWh) | 206 | 207 | 212 | 214 | 217 |
| (Acquisitions)/divestments | 0 | (0) | - | - | - | | | | | | |
| Other | - | - | - | - | - | LWAP (\$/MWh) | 92 | 139 | 133 | 109 | 97 |
| Funding available/(required) | 159 | 162 | 182 | 215 | 258 | LWAP/GWAP | 1.01 | 0.97 | 1.01 | 1.01 | 1.01 |
| Dividends paid | (148) | (132) | (139) | (143) | (167) | Line losses (%) | 5.3 | 5.4 | 5.6 | 5.6 | 5.6 |
| Equity raised/(returned) | (1) | (1) | - | - | - | | | | | | |
| Increase/(decrease) in net debt | (10) | (29) | (43) | (72) | (91) | Retail gas customers (000) | 106.2 | 107.1 | 107.2 | 107.7 | 108.2 |
| | | | | | | Retail gas volumes (PJ) | 7.5 | 8.2 | 8.4 | 8.5 | 8.6 |
| Balance Sheet (NZ\$m) | | | | | 2018A 2019A 2020E 2021E 2022E | | | | | | |
| Working capital | 90 | 111 | 112 | 124 | 132 | Gas volume/cust (GJ/yr) | 70.5 | 76.7 | 78.6 | 79.0 | 79.4 |
| Fixed assets | 3,430 | 3,717 | 3,664 | 3,536 | 3,371 | LPG retail sales (tonnes) | 35,005 | 38,507 | 42,925 | 46,590 | 49,141 |
| Intangibles | 364 | 364 | 368 | 362 | 355 | Kupe production | | | | | |
| Other assets | 84 | 121 | 121 | 121 | 121 | Gas production (PJ) | 11.8 | 11.8 | 10.5 | 10.0 | 11.5 |
| Total funds employed | 3,968 | 4,313 | 4,264 | 4,143 | 3,979 | Oil production (k barrels) | 533 | 473 | 381 | 355 | 564 |
| Net debt/(cash) | 1,206 | 1,228 | 1,272 | 1,216 | 1,126 | LPG production (k tonnes) | 45.9 | 50.6 | 45.2 | 42.4 | 47.8 |
| Other non current liabilities | 806 | 934 | 921 | 905 | 881 | | | | | | |
| Shareholder's funds | 1,956 | 2,151 | 2,071 | 2,023 | 1,972 | Kupe EBITDAF (\$m) | 115 | 109 | 98 | 94 | 121 |
| Minority interests | - | - | - | - | - | Energy EBITDAF (\$m) | 245 | 255 | 267 | 315 | 331 |
| Total funding sources | 3,968 | 4,313 | 4,264 | 4,143 | 3,979 | GNE EBITDAF (\$m) | 361 | 363 | 365 | 410 | 453 |

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Summary 1Q20 operating statistics

Figure 1. Summary 1Q20 operating statistics

| | Sep-18 1Q19 | Sep-19 1Q20 | % Chg |
|---|----------------|----------------|--------------|
| Retail electricity sales (GWh) | | | |
| Mass market (MM) | 960 | 940 | -2.1% |
| Small, medium enterprises (SME) | 274 | 290 | 5.7% |
| Commercial and industrial (C&I) | 490 | 488 | -0.4% |
| Total fixed price variable volume (FPVV) | 1,725 | 1,718 | -0.4% |
| Electricity customer numbers (000) | 502.2 | 502.0 | 0.0% |
| Electricity customer number additions (000) | (1.5) | 2.5 | |
| MM sales/customer (MWh/customer) | 2.45 | 2.46 | 0.1% |
| MM sales price (\$/MWh) | \$247.7 | \$253.5 | 2.3% |
| SME sales price (\$/MWh) | \$215.1 | \$214.9 | -0.1% |
| C&I average selling price (\$/MWh) | \$132.6 | \$150.4 | 13.4% |
| Weighted average FPVV selling price (\$/MWh) | \$209.8 | \$217.7 | 3.7% |
| Electricity netback (\$/MWh) | \$107.4 | \$114.0 | 6.1% |
| LWAP (\$/MWh) | \$88.1 | \$125.7 | 43% |
| Retail gas sales (PJ) | | | |
| Mass market (incl SME) | 1.7 | 1.7 | 0.5% |
| C&I gas sales | 1.0 | 1.1 | 10.0% |
| Total gas sales | 2.7 | 2.8 | 4.2% |
| Gas customer numbers (000) | 106.3 | 106.4 | 0.2% |
| Gas consumption/customer (GJ) | 15.6 | 15.6 | 0.0% |
| Retail gas price (\$/GJ) | \$22.0 | \$22.2 | 0.7% |
| Gas netback (\$/GJ) | \$8.7 | \$9.3 | 6.9% |
| Retail LPG sales (tonnes) | | | |
| Bottled sales | 4,817 | 5,562 | 15.5% |
| Other bulk & SME sales | 5,705 | 7,560 | 32.5% |
| Total retail LPG sales | 10,522 | 13,122 | 24.7% |
| LPG connections (000) | 64.1 | 70.4 | 9.8% |
| LPG connection additions | 1.7 | 1.9 | 11.2% |
| LPG consumption/connections (kg) | 76.2 | 80.1 | 5.2% |
| LPG netback (\$/tonne) | \$863 | \$1,031 | 19.5% |
| Generation (GWh) | | | |
| Hydro | 991 | 759 | -23% |
| Coal - Rankine units | 96 | 361 | 276% |
| Gas - Rankine units | 39 | 19 | -51% |
| Gas - Units 5 & 6 | 649 | 706 | 9% |
| Wind | 6 | 6 | 0% |
| Total generation | 1,781 | 1,851 | 4% |
| GWAP (\$/MWh) | \$85.7 | \$124.6 | 45% |
| LWAP/GWAP | 102.9% | 100.9% | -2% |
| Portfolio fuel cost (\$/MWh) | \$30.1 | \$47.8 | 59% |
| Kupe sales and production | | | |
| Oil production (barrels) | 129,976 | 110,999 | -15% |
| Oil sales (barrels) | 69,924 | 65,938 | -6% |
| Gas sales (PJ) | 3.0 | 3.0 | 0% |
| LPG sales (000 tonnes) | 13,380 | 13,875 | 4% |
| Barrels of oil equivalent | 665,688 | 666,008 | 0% |

Source: GNE, Forsyth Barr analysis

Summary forecast changes

Figure 2. Summary forecast changes

| | FY20 | FY20 | Diff | FY21 | FY21 | Diff | FY21 | FY21 | Diff |
|------------------------|------------|------------|--------------|------------|------------|-------------|------------|------------|-------------|
| | Old | New | % Chg | Old | New | % Chg | Old | New | % Chg |
| Sales revenue | 2,513 | 2,656 | 5.7% | 2,408 | 2,433 | 1.1% | 2,399 | 2,395 | -0.1% |
| EBITDAF | 367 | 365 | -0.5% | 406 | 410 | 0.9% | 446 | 453 | 1.4% |
| EBIT | 156 | 155 | -1.2% | 193 | 196 | 1.8% | 215 | 221 | 2.9% |
| Pre-tax profit | 84 | 82 | -2.3% | 127 | 131 | 2.6% | 154 | 160 | 4.0% |
| NPAT | 60 | 59 | -2.3% | 92 | 94 | 2.6% | 111 | 115 | 4.0% |
| Earnings (cps) | 5.9 | 5.7 | -2.4% | 8.8 | 9.0 | 2.5% | 10.6 | 11.0 | 3.9% |
| Dividend (cps) | 17.4 | 17.4 | 0.0% | 17.7 | 17.7 | 0.0% | 18.0 | 18.0 | 0.0% |
| Generation (GWh) | 6,375 | 6,568 | 3.0% | 6,377 | 6,377 | 0.0% | 6,377 | 6,377 | 0.0% |
| FPVV sales (GWh) | 6,080 | 6,128 | 0.8% | 6,080 | 6,139 | 1.0% | 6,079 | 6,138 | 1.0% |
| Customer numbers (000) | 494 | 499 | 1.0% | 490 | 494 | 1.0% | 487 | 492 | 1.0% |
| GWAP (\$/MWh) | \$115.0 | \$131.5 | 14.3% | \$107.2 | \$108.1 | 0.8% | \$100.7 | \$96.6 | -4.0% |
| LWAP/GWAP | 1.008 | 1.011 | 0.2% | 1.008 | 1.007 | 0.0% | 1.006 | 1.006 | 0.0% |

Source: Forsyth Barr analysis

Investment summary

Our rating is **OUTPERFORM**. GNE is trading on the sector leading dividend yield and market multiples. It also has the strongest near-term growth profile, aided by high cost gas contracts rolling off from FY21 onwards. Its downside risks to NZAS closing are also amongst the lowest in the sector.

Business quality

- **Low risk, modest growth industry:** Electricity demand is relatively inelastic and is expected to grow slowly in the future. The industry is well positioned to benefit from NZ decarbonising transport and industrial heat.
- **Unique generation position:** Most of the value within the electricity sector lies within the generation assets. GNE has the only coal plant which is critical cover for low hydro years. Historically, monetising GNE's thermal position has been difficult, although we expect that to improve.

Earnings and cash flow outlook

- **Strategy refresh:** GNE has announced a strategy refresh which will see it embracing new technology and focussing more on the customer. GNE is targeting FY21 EBITDAF of \$400m+.
- **Gas relief coming:** GNE currently has too much gas due to legacy high priced take or pay contracts. These contracts start to roll-off after 2020, providing an earnings tailwind.

Financial structure

- **Balance sheet:** Whilst we are comfortable with debt levels, GNE's balance sheet has limited spare capacity following the acquisitions of Nova's LPG business and increasing its Kupe stake. GNE is lowering gearing through the use of a dividend reinvestment plan (DRP).

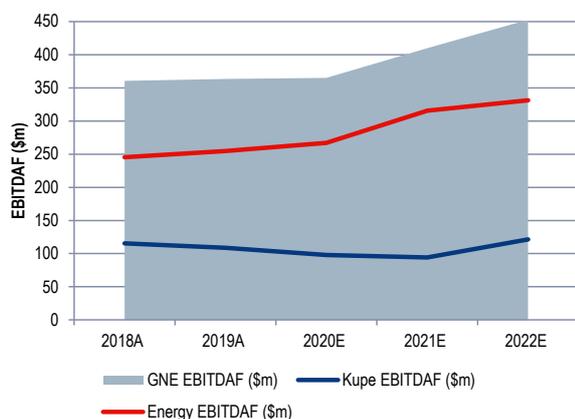
Key risks

- **Increasing carbon costs:** GNE is required to relinquish an increasing value of carbon credits. Higher carbon prices combine to create financial headwinds for the next few years.
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our view, the smelter is unlikely to close (less than 10% chance) and the downside risks are fully factored into GNE's share price.
- **Rising bond yields:** In recent years GNE has traded in line with bond yields. A lift in interest rates is likely to see GNE trade lower, although in our view interest rates will probably remain low for the foreseeable future.

Company description

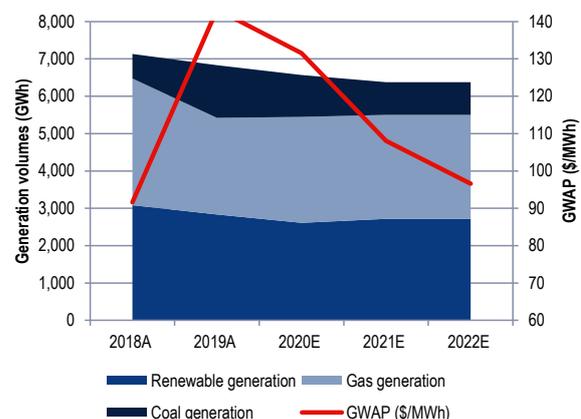
Genesis Energy is a large NZ electricity generator/retailer producing ~7,000GWh of electricity from its hydro and thermal power stations. It owns the only coal fired power station in NZ (which is a core asset to reduce dry year risk), a large gas-fired power station and several hydro power stations in the North and South islands. It is NZ's largest energy retailer, retailing electricity, gas & LPG to ~665,000 customers under its Genesis Energy and Energy Online brands and has a relationship with SPK to resell broadband services. It also owns 46% of the producing Kupe oil and gas field, taking 100% of Kupe gas to sell and/or use in its power stations.

Figure 3. EBITDAF split



Source: GNE, Forsyth Barr analysis

Figure 4. Generation volumes and average price received



Source: GNE, Forsyth Barr analysis

Figure 5. Substantial Shareholders

| Shareholder | Latest Holding |
|-------------|----------------|
| NZ Govt | 51.8% |

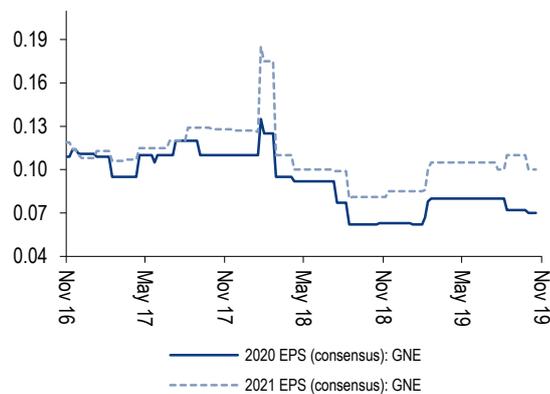
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International Compcos

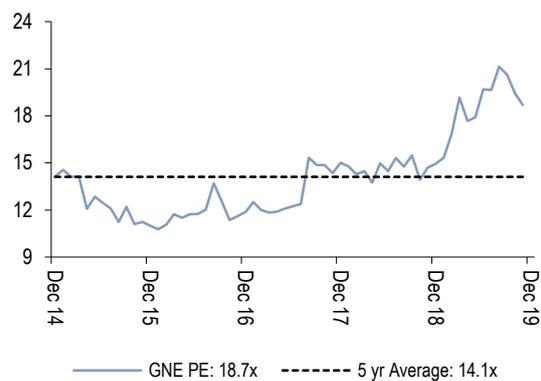
| Company | Code | Price | Mkt Cap (m) | PE | | EV/EBITDA | | EV/EBIT | | Cash D/Yld |
|---|--------|----------|----------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|
| | | | | 2020E | 2021E | 2020E | 2021E | 2020E | 2021E | |
| <i>(metrics re-weighted to reflect GNE's balance date - June)</i> | | | | | | | | | | |
| Genesis Energy | GNE NZ | NZ\$3.16 | NZ\$3,248 | 20.8x | 16.4x | 12.1x | 10.8x | 28.7x | 22.6x | 5.6% |
| Contact Energy * | CEN NZ | NZ\$7.25 | NZ\$5,204 | 20.9x | 20.0x | 13.2x | 12.7x | 23.3x | 21.8x | 5.4% |
| Meridian Energy * | MEL NZ | NZ\$4.60 | NZ\$11,790 | 24.6x | 26.8x | 16.1x | 17.2x | 25.9x | 28.3x | 4.7% |
| Mercury * | MCY NZ | NZ\$4.87 | NZ\$6,634 | 26.9x | 24.0x | 15.0x | 14.6x | 24.7x | 23.9x | 3.3% |
| Trustpower * | TPW NZ | NZ\$8.26 | NZ\$2,585 | 24.4x | 23.5x | 14.9x | 14.4x | 18.7x | 18.0x | 4.3% |
| AGL Energy | AGL AT | A\$19.66 | A\$12,760 | 15.1x | 15.1x | 7.4x | 7.3x | 11.2x | 11.4x | 5.0% |
| ERM Power | EPW AT | A\$2.41 | A\$603 | 12.1x | 16.2x | 7.1x | 6.7x | 10.1x | 9.5x | 4.2% |
| Origin Energy | ORG AT | A\$8.07 | A\$14,213 | 13.7x | 13.2x | 6.3x | 6.2x | 13.8x | 13.4x | 4.5% |
| Compcos Average: | | | | 19.7x | 19.8x | 11.4x | 11.3x | 18.3x | 18.0x | 4.5% |
| GNE Relative: | | | | +6% | -17% | +6% | -4% | +57% | +25% | +24% |

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcos metrics re-weighted to reflect headline (GNE) companies fiscal year end

Figure 7. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 8. 12 Month Forward PE


Source: Forsyth Barr analysis

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