

Genesis Energy

OUTPERFORM

Kupe Key to Cover Fuel Cost Rises — 2Q20 Operating Performance

Genesis Energy's (GNE) 2Q20 featured a strong retail performance, with netbacks increasing across all energy products, offset by high generation fuel costs and the planned Kupe outage. GNE also indicated 1H20 EBITDAF is likely to be ~\$167m, ~-15% lower than the pcp. This was worse than we had expected, with fuel costs the main issue.

What's changed?

- **Earnings:** FY20 EBITDAF -\$4m lower to \$362m
- **Target Price:** Reduced -8cps (-2.5%) to \$3.15
- **Rating:** OUTPERFORM rating unchanged

Retail performance shines again

GNE's retail segment continues to perform well. Sales volumes were generally strong (electricity up +2.8%, LPG up +16.9%), and netbacks, an indicator of profitability, were up across electricity (+1.6%), gas (+11.4%) and LPG (+23.9%). GNE has been increasing prices, which has had a small negative effect on connection numbers.

Generation fuel cost increases and Kupe volumes the negatives

Whilst we knew fuel costs were increasing, the magnitude of the increase was greater than expected. The combined cost of coal/gas generation increased +20% vs. the pcp to \$82/MWh and the mix change was favourable for 2Q20 (more gas generation than coal). The other headwind was reduced Kupe production volumes due to a planned maintenance shut-down. The shut-down had been well signalled and its effect expected.

These headwinds have combined to lower 1H20 EBITDAF ~-15% below the pcp to ~\$167m. GNE will be reporting its 1H20 result on Friday, 21 February.

Forecast changes reflect higher costs and increase Kupe production

Whilst 2Q20 Kupe production was suppressed, GNE has indicated that work in 3Q20 will hopefully boost production for the last four months of the year. We believe GNE needs these volumes to come through to meet its current FY20 EBITDAF guidance range of \$360m to \$380m.

We have lowered our FY20 EBITDAF forecast -\$4m to \$362m. Most of the decrease is due to higher fuel costs (up +\$13m) offset by increased Kupe production, boosting Kupe earnings +\$6m. Higher fuel costs and Kupe production is a feature of the changes in later year forecasts too.

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\$3.25
Target price	3.15
Risk rating	Low
Issued shares	1029.4m
Market cap	NZ\$3,341m
Avg daily turnover	507.5k (NZ\$1,626k)

Share Price Performance



Financials	19A	20E	21E	22E
NPAT* (NZ\$m)	158.9	155.3	200.1	247.9
EPS* (NZc)	15.5	15.0	19.1	23.6
EPS growth* (%)	21.7	-3.3	27.4	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	12.5	12.6	11.2	10.2
EV/EBIT	27.1	30.7	24.3	21.1
PE	20.9	21.6	17.0	13.8
Price / NTA	1.9	2.0	2.1	n/a
Cash div yld (%)	5.3	5.3	5.4	5.5
Gross div yld (%)	6.9	7.2	7.4	7.6

*Historic/forecast numbers based on normalised profits

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Genesis Energy Limited (GNE)
Priced as at 23 Jan 2020 (NZ\$)

3.25

12-month target price (NZ\$)*

3.15

Spot valuations (NZ\$)

Expected share price return	-3.1%	1. DCF	2.72
Net dividend yield	5.4%	2. Market multiple	3.01
Estimated 12-month return	2.3%	3. Dividend yield	3.60

Key WACC assumptions

Risk free rate	2.00%
Equity beta	0.88
WACC	6.8%
Terminal growth	1.5%

DCF valuation summary (NZ\$m)

Total firm value	4,110
(Net debt)/cash	(1,255)
Less: Capitalised operating leases	
Value of equity	2,855

Profit and Loss Account (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Sales revenue	2,305	2,701	2,640	2,461	2,382
Normalised EBITDA	361	363	362	407	449
Depreciation and amortisation	(206)	(197)	(214)	(220)	(233)
Normalised EBIT	155	167	148	188	216
Net interest	(74)	(73)	(72)	(65)	(60)
Associate income	-	-	-	-	-
Tax	(22)	(27)	(21)	(34)	(44)
Depreciation capex adjustment	71	92	101	112	136
Adjusted normalised NPAT	129	159	155	200	248
Abnormals/other	(109)	(100)	(101)	(112)	(136)
Reported NPAT	20	59	55	88	112
Normalised EPS (cps)	12.8	15.5	15.0	19.1	23.6
DPS (cps)	16.9	17.1	17.4	17.7	18.0

Valuation Ratios

	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	12.6	12.5	12.6	11.2	10.2
EV/EBIT (x)	29.3	27.1	30.7	24.4	21.2
PE (x)	25.5	20.9	21.7	17.0	13.8
Price/NTA (x)	2.1	1.9	2.0	2.1	2.1
Free cash flow yield (%)	4.7	4.9	5.6	6.7	7.6
Net dividend yield (%)	5.2	5.2	5.3	5.4	5.5
Gross dividend yield (%)	6.8	6.9	7.2	7.4	7.6

Capital Structure

	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	1.4	2.1	2.0	2.9	3.6
Interest cover EBITDA (x)	4.9	5.0	5.0	6.3	7.5
Net debt/ND+E (%)	37.7	35.5	37.2	36.6	35.4
Net debt/EBITDA (x)	3.3	3.3	3.4	2.8	2.4

Growth Rates

	2018A	2019A	2020A	2021A	2022A
Revenue (%)	18.1	17.2	-2.2	-6.8	-3.2
EBITDA (%)	5.9	0.8	-0.4	12.5	10.3
EBIT (%)	-2.0	7.8	-11.3	26.7	15.2
Normalised NPAT (%)	-18.9	23.5	-2.3	28.8	23.9
Normalised EPS (%)	-19.6	21.7	-3.3	27.4	23.3
Ordinary DPS (%)	1.8	0.9	1.8	1.7	1.7

Key Ratios

	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	2.4	3.4	3.3	4.3	5.2
Return on equity (%)	3.0	3.1	2.6	4.4	5.7
Return on funds employed (%)	3.6	3.6	3.2	4.3	5.1
EBITDA margin (%)	15.6	13.5	13.7	16.6	18.9
EBIT margin (%)	6.7	6.2	5.6	7.6	9.1
Capex to sales (%)	4.7	2.5	2.8	2.6	2.4
Capex to depreciation (%)	52	35	35	29	24
Imputation (%)	80	80	90	95	95
Pay-out ratio (%)	132	110	116	92	76

Cash Flow (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
EBITDA	361	363	362	407	449
Working capital change	33	(27)	7	(2)	(9)
Interest & tax paid	(120)	(123)	(108)	(117)	(128)
Other	(7)	17	-	-	-
Operating cash flow	266	231	261	288	313
Capital expenditure	(108)	(69)	(74)	(64)	(57)
(Acquisitions)/divestments	0	(0)	-	-	-
Other	-	-	-	-	-
Funding available/(required)	159	162	187	224	256
Dividends paid	(148)	(132)	(139)	(143)	(167)
Equity raised/(returned)	(1)	(1)	-	-	-
(Increase)/decrease in net debt	10	29	49	81	89

Operating Performance

	2018A	2019A	2020E	2021E	2022E
Renewable generation	3,084	2,835	2,742	2,716	2,716
Gas generation	3,392	2,586	2,785	2,787	2,787
Coal generation	657	1,410	1,102	876	876
Total GNE generation (GWh)	7,133	6,831	6,629	6,380	6,380
GWAP (\$/MWh)	92	143	123	110	96

Retail electricity

	2018A	2019A	2020E	2021E	2022E
Electricity customers (000)	504	499	495	490	488
MM/SME volumes	4,169	4,077	4,097	4,078	4,056
TOU volumes	1,811	1,992	2,037	2,058	2,078

Total fixed price volumes (GWh)

	2018A	2019A	2020E	2021E	2022E
Average MM usage/cust (kWh/yr)	8,240	8,126	8,237	8,279	8,308
Average FPV price (\$/MWh)	206	207	212	215	217
LWAP (\$/MWh)	92	139	122	112	97
LWAP/GWAP	1.01	0.97	0.99	1.01	1.01
Line losses (%)	5.3	5.4	5.6	5.6	5.6

Kupe production

	2018A	2019A	2020E	2021E	2022E
Gas production (PJ)	11.8	11.8	11.2	11.1	11.7
Oil production (k barrels)	532.8	472.9	395.0	382.4	555.8
LPG production (k tonnes)	45.9	50.6	49.4	49.5	52.7
Kupe EBITDAF (\$m)	115.3	108.8	104.5	107.8	127.2
Energy EBITDAF (\$m)	245.2	254.6	257.5	299.6	322.3
GNE EBITDAF (\$m)	360.5	363.4	362.1	407.4	449.5

Balance Sheet (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Working capital	90	111	104	106	115
Fixed assets	3,430	3,717	3,661	3,526	3,359
Intangibles	364	364	368	362	355
Right of use asset	-	-	-	-	-
Other assets	84	121	121	121	121
Total funds employed	3,968	4,313	4,253	4,116	3,950
Net debt/(cash)	1,206	1,228	1,267	1,201	1,114
Lease liability	-	-	-	-	-
Other liabilities	806	934	920	902	878
Shareholder's funds	1,956	2,151	2,067	2,012	1,958
Minority interests	-	-	-	-	-
Total funding sources	3,968	4,313	4,253	4,116	3,950

2Q20 Operating Statistics

Figure 1. 2Q20 operating statistics and commentary

	Dec-18 2Q18	Dec-19 2Q19	% Chg	Comments
Retail electricity sales (GWh)				
Mass market (MM)	659	661	0.3%	Mass market flat
Small, medium enterprises (SME)	266	287	7.8%	GNE's push into SME market continues to add volumes
Commercial and industrial (C&I)	489	507	3.6%	Small increase in C&I volumes
Total fixed price variable volume (FPVV)	1,415	1,455	2.8%	
Electricity customer numbers (000)	501.7	497.4	-0.8%	
Electricity customer number additions (000)	(0.5)	(4.6)		Significant drop in the past quarter following price rises
MM sales/customer (MWh/customer)	1.84	1.90	2.9%	Good lift in volumes, we suspect due to GNE picking up more agri volume
MM sales price (\$/MWh)	\$258.6	\$265.0	2.5%	Modest lift in sale price
SME sales price (\$/MWh)	\$226.7	\$223.3	-1.5%	
C&I average selling price (\$/MWh)	\$121.2	\$116.0	-4.2%	C&I prices include some spot volume customers that had lower w/sale prices
Weighted avg FPVV selling price (\$/MWh)	\$205.0	\$204.8	-0.1%	
Electricity netback (\$/MWh)	\$99.8	\$101.4	1.6%	Small increase in electricity netback this quarter
LWAP (\$/MWh)	\$210.4	\$104.2	-50%	
Retail gas sales (PJ)				
Mass market (incl SME)	1.0	1.0	0.0%	
C&I gas sales	0.9	0.8	-11.1%	
Total gas sales	1.8	1.7	-5.2%	
Gas customer numbers (000)	106.9	105.6	-1.2%	
Gas consumption/customer (GJ)	9.0	9.1	0.5%	
Retail gas price (\$/GJ)	\$27.5	\$28.5	3.7%	Gas cost increases being passed through to customers
Gas netback (\$/GJ)	\$8.8	\$9.8	11.4%	Strong increase in gas netback
Retail LPG sales (tonnes)				
Bottled sales	3,656	3,949	8.0%	Continued strong growth in the LPG market
Other bulk & SME sales	5,202	6,404	23.1%	
Total retail LPG sales	8,858	10,353	16.9%	
LPG connections (000)	65.8	71.3	8.4%	
LPG connection additions	1.8	1.0	-45.2%	
LPG consumption/connections (kg)	56.3	55.7	-1.0%	
LPG netback (\$/tonne)	\$775	\$960	23.9%	Big increase in LPG netback, although 2.5% of the increase due to accounting
Generation (GWh)				
Hydro	711	693	-3%	
Coal - Rankine Units	512	304	-41%	Rankine units had to run harder in pcp due to Unit 5 unavailability
Gas - Rankine units	101	34	-66%	
Gas - Units 5 & 6	293	565	93%	Mid-life refurb took place in the pcp, and the Pohokura outage
Wind	5	7	40%	
Total generation	1,622	1,603	-1%	
GWAP (\$/MWh)	\$212.3	\$108.2	-49%	
LWAP/GWAP	99.1%	96.3%	-3%	Improved LWAP/GWAP ratio
Portfolio fuel cost (\$/MWh)	\$38.3	\$46.0	20%	Big increase in coal and gas costs impacted profitability
Kupe sales and production				
Oil production (barrels)	105,508	65,732	-38%	Kupe scheduled outage lowered 2Q20 production. Oil production fell slightly
Oil sales (barrels)	97,774	71,864	-27%	faster due to natural decline in the field
Gas sales (PJ)	2.5	1.8	-28%	
LPG sales (000 tonnes)	10,325	8,022	-22%	
Barrels of oil equivalent	594,800	434,126	-27%	

Source: GNE, Forsyth Barr analysis

Forecast changes

Figure 2. Forecast changes

	FY20	FY20		FY21	FY21		FY22	FY22	
	Old	New		Old	New		Old	New	
	\$m	\$m	% Chg	\$m	\$m	% Chg	\$m	\$m	% Chg
Energy revenue	2,513	2,489	-1%	2,295	2,307	0%	2,224	2,204	-1%
Kupe revenue	144	151	5%	139	154	11%	175	178	2%
Total revenue	2,657	2,640	-1%	2,434	2,461	1%	2,399	2,382	-1%
Energy operating costs	(2,247)	(2,231)	-1%	(1,980)	(2,007)	1%	(1,893)	(1,882)	-1%
Kupe operating costs	(45)	(47)	4%	(44)	(47)	6%	(50)	(50)	1%
Energy EBITDAF	267	257	-4%	315	299	-5%	331	322	-3%
Kupe EBITDAF	99	105	6%	95	108	14%	125	127	2%
Reported EBITDAF	366	362	-1%	410	407	-1%	456	449	-1%
Depn & amort	(210)	(214)	2%	(214)	(220)	3%	(231)	(233)	1%
EBIT	155	148	-5%	197	188	-5%	225	216	-4%
Net interest	(73)	(72)	0%	(66)	(65)	-1%	(61)	(60)	-1%
Pre-tax profit	83	76	-8%	131	123	-7%	164	156	-5%
Tax	(23)	(21)	-8%	(37)	(34)	-7%	(46)	(44)	-5%
NPAT	59	55	-8%	95	88	-7%	118	112	-5%
Adjusted normalised NPAT	158	155	-2%	202	200	-1%	244	239	-2%
EPS (cps)	5.7	5.3	-8%	9.0	8.4	-7%	11.2	10.7	-5%
Adjusted EPS	15.2	15.0	-2%	19.3	19.1	-1%	23.2	22.8	-2%
Dividend (cps)	17.4	17.4	0%	17.7	17.7	0%	18.0	18.0	0%
Operating statistics			Diff			Diff			Diff
Generation (GWh)	6,568	6,629	1%	6,377	6,380	0%	6,377	6,380	0%
FPVV sales (GWh)	6,128	6,135	0%	6,139	6,135	0%	6,138	6,135	0%
Electricity cust. # (000)	499	495	-1%	494	490	-1%	492	488	-1%
GWAP (\$/MWh)	\$131.5	\$123.0	-6%	\$108.1	\$110.4	2%	\$96.6	\$96.3	0%
LWAP/GWAP	1.011	0.990	-2%	1.007	1.011	0%	1.006	1.009	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).

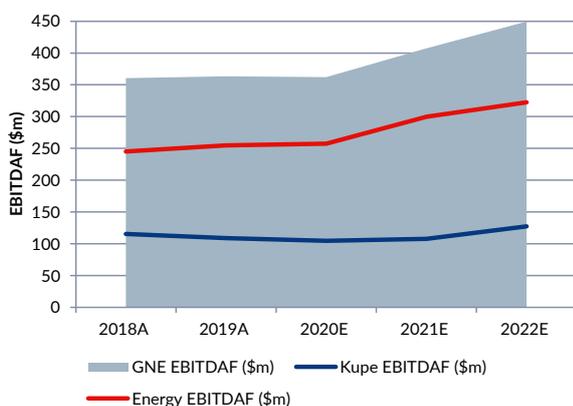
Key risks

- **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

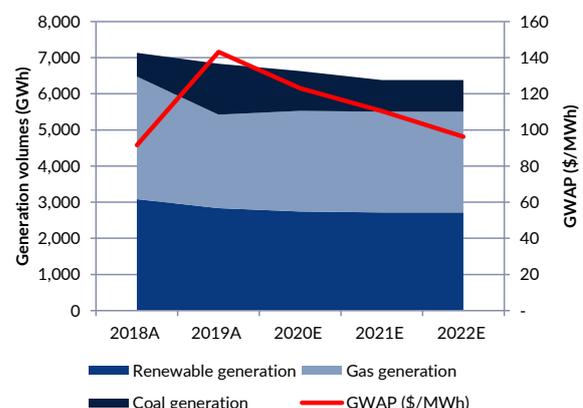
Genesis Energy is a large NZ electricity generator/retailer producing ~7,000GWh of electricity from its hydro and thermal power stations. It owns the only coal fired power station in NZ (which is a core asset to reduce dry year risk), a large gas-fired power station and several hydro power stations in 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

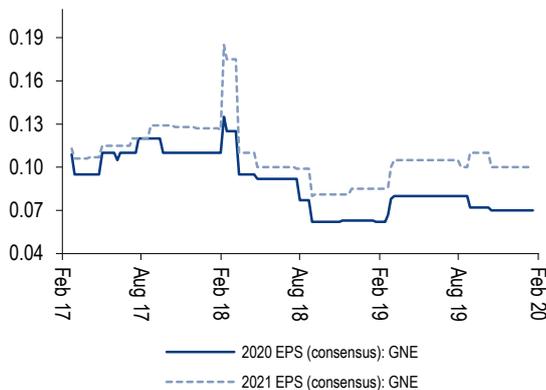
Figure 6. International Compcos

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\$3.25	NZ\$3,341	21.6x	17.0x	12.5x	11.1x	30.6x	24.1x	5.4%
Contact Energy *	CEN NZ	NZ\$7.42	NZ\$5,328	22.9x	20.4x	14.1x	12.9x	25.9x	22.0x	5.3%
Meridian Energy *	MEL NZ	NZ\$5.33	NZ\$13,661	26.6x	29.0x	17.5x	18.7x	27.3x	29.8x	4.1%
Mercury *	MCY NZ	NZ\$5.34	NZ\$7,275	29.9x	26.8x	16.4x	16.0x	26.7x	26.0x	3.0%
Trustpower *	TPW NZ	NZ\$7.47	NZ\$2,338	24.1x	22.5x	14.2x	13.7x	17.5x	16.9x	4.6%
AGL Energy	AGL AT	A\$20.24	A\$12,933	15.7x	15.7x	7.5x	7.4x	11.4x	11.7x	4.8%
ERM Power	EPW AT	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Origin Energy	ORG AT	A\$8.72	A\$15,358	14.4x	14.1x	6.5x	6.5x	15.2x	16.0x	4.3%
Compcos Average:				22.3x	21.4x	12.7x	12.5x	20.7x	20.4x	4.4%
GNE Relative:				-3%	-21%	-1%	-11%	+48%	+18%	+24%

EV = Current Market Cap + Actual Net Debt

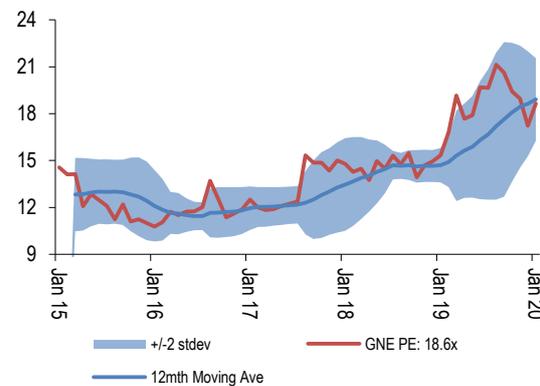
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcos metrics re-weighted to reflect headline (GNE) companies fiscal year end

Figure 7. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 8. 12 Month Forward PE



Source: Forsyth Barr analysis

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