

Genesis Energy

Kupe Strategic Review a Positive

ANDREW HARVEY-GREEN

 andrew.harvey-green@forsythbarr.co.nz
 +64 4 495 8185

SCOTT ANDERSON

 scott.anderson@forsythbarr.co.nz
 +64 4 914 2219

OUTPERFORM

Genesis Energy (GNE) has announced it is undertaking a strategic review of its 46% interest in the Kupe oil and gas field. The review will determine whether GNE retains or sells its stake in the field. The review outcome is expected to be announced in mid 2021, and we consider a sale is the most likely outcome of the review as the strategic need for GNE to own Kupe will diminish over time. We view the decision to undertake a strategic review as a positive.

NZX Code	GNE	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$3.29	NPAT* (NZ\$m)	154.3	188.8	192.3	155.4	PE	22.1	18.2	18.1	22.6
Target price	NZ\$3.38	EPS* (NZc)	14.9	18.0	18.2	14.6	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	Low	EPS growth* (%)	-5.0	21.1	0.9	-19.9	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	1043.6m	DPS (NZc)	17.2	14.0	14.0	14.0	Price / NTA	2.0	2.1	2.1	2.3
Market cap	NZ\$3,428m	Imputation (%)	80	100	95	70	Cash div yld (%)	5.2	4.3	4.3	4.3
Avg daily turnover	568.1k (NZ\$1,673k)	*Based on normalised profits					Gross div yld (%)	6.9	5.9	5.8	5.4

Strategic review a positive move

GNE is effectively deciding whether to sell its Kupe stake or not. There are a number of reasons why selling Kupe now is attractive for GNE, including 1) firm gas prices as a result of the restricted Pohokura supply, 2) exiting Kupe before it enters its decline phase, and 3) selling before further exploration and drilling, which would change the risk and return profile of the investment. In addition, selling Kupe will likely improve GNE's ESG perception. As part of the review, GNE will also be considering its capital structure, although somewhat surprisingly in our view this will not include a review of GNE's dividend policy.

Impact on earnings and dividend sustainability

GNE has indicated that the sale of Kupe will not impact its dividend. However, with Kupe producing between 25%-30% of GNE's annual EBITDAF, stripping out Kupe will have an impact on GNE's ability to maintain its dividend profile. We are forecasting FY21 free cash flow of 18.7cps, which would fall to 13.4cps without Kupe earnings, well below GNE's FY20 17.2cps dividend. In simple terms, the reduction in interest costs from selling Kupe is materially less than Kupe's cash flow contribution. However, GNE's dividend reinvestment plan and future earnings growth (due to the lower contracted gas prices) should ensure debt levels stay at manageable levels.

What could Kupe sell for and who are the potential buyers?

We estimate that Kupe could sell for between NZ\$250m and NZ\$400m. The net book value of Kupe on GNE's balance sheet is ~NZ\$227m (22cps). Our Kupe DCF value is NZ\$286m (27cps) – however, this does not include any exploration upside. The two recent Kupe transactions are GNE acquiring NZO's 15% stake and NZO acquiring Mitsui's 4% stake, both with an effective date of 1 Jan 2017. Those transactions imply a 46% Kupe stake of between NZ\$402m to NZ\$515m as of January 2017. Since then, gas prices have firmed, oil prices and interest rates have fallen, and we estimate GNE's Kupe cash flows from the past 3.5 years is ~NZ\$300m. Estimating the possible sale price is challenging as GNE may alter the gas contract price for the 46% it is selling.

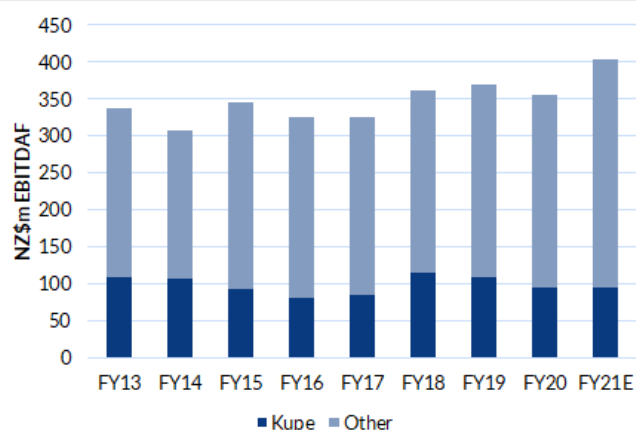
Potential buyers of Kupe appear limited. Todd Energy and OMV are the largest gas producers by a significant margin, potentially raising Commerce Commission issues. That only leaves three other gas producers; Beach Energy, NZ Oil & Gas and Greymouth Petroleum. The offshore oil and gas ban means it is highly unlikely that an offshore player will come into the market. Whilst Kupe is a great oil & gas asset, creating bidding tension could be the greatest challenge for GNE.

Genesis Energy Limited (GNE)

Priced as at 27 Nov 2020 (NZ\$)						3.29						
12-month target price (NZ\$)*						3.38	Spot valuations (NZ\$)					
Expected share price return						2.7%	1. DCF					2.92
Net dividend yield						4.3%	2. Market multiple					2.90
Estimated 12-month return						7.0%	3. Dividend yield					3.07
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						1.30%	Total firm value					4,363
Equity beta						0.84	(Net debt)/cash					(1,320)
WACC						5.1%	Less: Capitalised operating leases					
Terminal growth						1.5%	Value of equity					3,044
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E	
Normalised EBITDA	3,410.0	3,354.5	3,345.0	2,657.7	2,421.6	EV/EBITDA (x)	12.6	13.2	11.5	12.2	14.3	
Depreciation and amortisation	369.4	355.6	402.4	373.8	319.6	EV/EBIT (x)	27.7	32.1	24.5	30.0	46.5	
Normalised EBIT	(201.7)	(209.8)	(213.9)	(221.9)	(221.4)	PE (x)	21.0	22.1	18.3	18.1	22.6	
Net interest	167.7	145.8	188.5	151.9	98.2	Price/NTA (x)	1.9	2.0	2.1	2.2	2.3	
Associate income	(77)	(71)	(66)	(62)	(58)	Free cash flow yield (%)	4.8	5.1	7.9	6.1	5.0	
Tax	0	0	0	0	0	Net dividend yield (%)	5.2	5.2	4.3	4.3	4.3	
Depreciation capex adjustment	(26)	(22)	(34)	(25)	(11)	Gross dividend yield (%)	6.8	6.9	5.9	5.8	5.4	
Adjusted normalised NPAT	96	101	101	127	126	Capital Structure						
Abnormals/other	160	154	189	192	155	Interest cover EBIT (x)	2.1	1.9	2.8	2.5	1.7	
Reported NPAT	(101)	(108)	(101)	(127)	(126)	Interest cover EBITDA (x)	4.8	5.0	6.1	6.1	5.5	
Normalised EPS (cps)	59	46	88	65	29	Net debt/ND+E (%)	36.6	37.6	35.8	34.5	34.6	
DPS (cps)	15.7	14.9	18.0	18.2	14.6	Net debt/EBITDA (x)	3.4	3.5	2.8	2.8	3.1	
	17.1	17.2	14.0	14.0	14.0	Key Ratios						
Growth Rates							2019A	2020A	2021E	2022E	2023E	
Revenue (%)	2019A	2020A	2021A	2022A	2023A	Return on assets (%)	3.4	2.9	4.3	3.7	2.5	
EBITDA (%)	48.0	-1.6	-0.3	-20.5	-8.9	Return on equity (%)	3.0	2.6	4.4	3.3	1.6	
EBIT (%)	2.5	-3.7	13.2	-7.1	-14.5	Return on funds employed (%)	3.6	3.2	4.3	3.6	2.5	
Normalised NPAT (%)	8.3	-13.1	29.3	-19.4	-35.4	EBITDA margin (%)	10.8	10.6	12.0	14.1	13.2	
Normalised EPS (%)	24.6	-3.8	22.4	1.8	-19.2	EBIT margin (%)	4.9	4.3	5.6	5.7	4.1	
Ordinary DPS (%)	22.7	-5.0	21.1	0.9	-19.9	Capex to sales (%)	2.0	2.1	2.2	2.2	2.5	
Cash Flow (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
EBITDA	2019A	2020A	2021E	2022E	2023E	Capex to depreciation (%)	34	33	35	27	27	
Working capital change	369.4	355.6	402.4	373.8	319.6	Imputation (%)	80	80	100	95	70	
Interest & tax paid	(27.3)	21.8	56.1	0.4	1.5	Pay-out ratio (%)	109	116	78	77	96	
Other	(123.1)	(119.2)	(114.3)	(105.5)	(89.9)	Operating Performance						
Operating cash flow	15.1	(12.4)	0	0	0	2019A	2020A	2021E	2022E	2023E		
Capital expenditure	234.1	245.8	344.3	268.7	231.2	Renewable generation	2,835	2,340	2,754	2,724	2,724	
(Acquisitions)/divestments	(68.5)	(69.0)	(74.0)	(59.5)	(60.7)	Gas generation	2,586	3,121	2,935	1,511	893	
Other	(0.2)	(7.6)	0	0	0	Coal generation	1,410	1,340	1,140	219	219	
Funding available/(required)	0	0	0	0	0	Total GNE generation (GWh)	6,831	6,801	6,829	4,455	3,836	
Dividends paid	165.4	169.2	270.3	209.2	170.5	GWAP (\$/MWh)	143	114	125	78	79	
Equity raised/(returned)	(131.6)	(138.4)	(131.7)	(118.8)	(119.9)	Retail electricity						
(Increase)/decrease in net debt	32.5	30.7	138.6	90.4	50.6	Electricity customers (000)	499	493	470	441	412	
Balance Sheet (NZ\$m)							2019A	2020A	2021E	2022E	2023E	
Working capital	2019A	2020A	2021E	2022E	2023E	MM/SME volumes	4,077	4,111	4,021	3,806	3,571	
Fixed assets	111.8	99.4	43.3	42.9	41.4	TOU volumes	1,992	2,134	2,113	1,415	948	
Intangibles	3,773.1	3,675.1	3,557.3	3,400.9	3,249.0	Total fixed price volumes (GWh)	6,068	6,245	6,134	5,222	4,519	
Right of use asset	364.0	353.4	356.1	352.1	346.3	Average MM usage/cust (kWh/yr)	8,126	8,333	8,315	8,345	8,362	
Other assets	0	0	0	0	0	Average FPV price (\$/MWh)	210	212	210	215	218	
Total funds employed	4,369.7	4,291.2	4,115.1	3,954.4	3,795.1	LWAP (\$/MWh)	139	110	124	75	75	
Net debt/(cash)	1,293.1	1,334.9	1,216.3	1,127.9	1,080.3	LWAP/GWAP	0.97	0.96	0.99	0.95	0.95	
Lease liability	0	0	0	0	0	Line losses (%)	5.4	5.6	5.6	5.6	5.6	
Other liabilities	931.6	886.5	872.6	854.2	833.3	Kupe production						
Shareholder's funds	2,145.0	2,068.0	2,024.4	1,970.5	1,879.7	Gas production (PJ)	11.8	10.7	11.2	11.8	11.3	
Minority interests	0	1.8	1.8	1.8	1.8	Oil production (k barrels)	472.9	374.3	359.8	497.1	432.6	
Total funding sources	4,369.7	4,291.2	4,115.1	3,954.4	3,795.1	LPG production (k tonnes)	50.6	46.6	49.3	52.3	50.7	
							2019A	2020A	2021E	2022E	2023E	
							109	94	98	113	107	
							260	262	304	261	213	
							369	356	402	374	319	

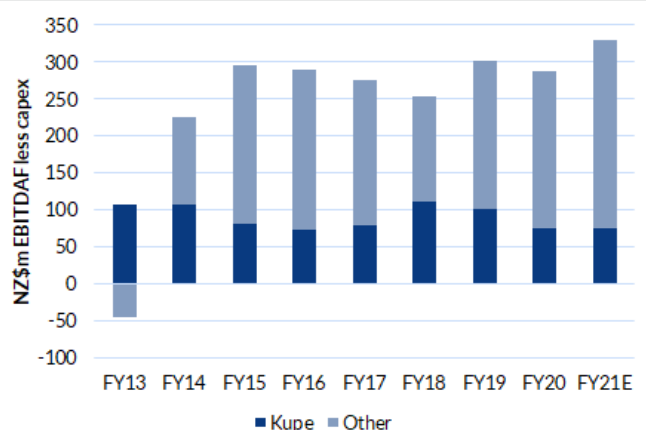
Kupe historic operating performance

Figure 1. EBITDAF split



Source: Forsyth Barr analysis

Figure 2. EBITDAF less capex split



Source: Forsyth Barr analysis

Kupe book value and proforma figures

Figure 3. Kupe book value of assets

	NZ\$m
Oil & gas assets (PPE)	307
Inventory	3
Goodwill	13
Rehabilitation provision (estimate)	(96)
Kupe book value	227

Source: GNE, Forsyth Barr analysis

Figure 4. Proforma

	FY21E	Kupe	Lower interest costs	FY21 ex-Kupe
EBITDAF	404	95		309
EBIT	191	56	7	141
NPAT	90	41	5	54
FCF proxy	195	60	5	140
FCF cps	18.7	5.7	0.4	13.4
Net debt	1,123	325		798
Net debt/EBITDA	2.8			2.6

Source: Forsyth Barr analysis

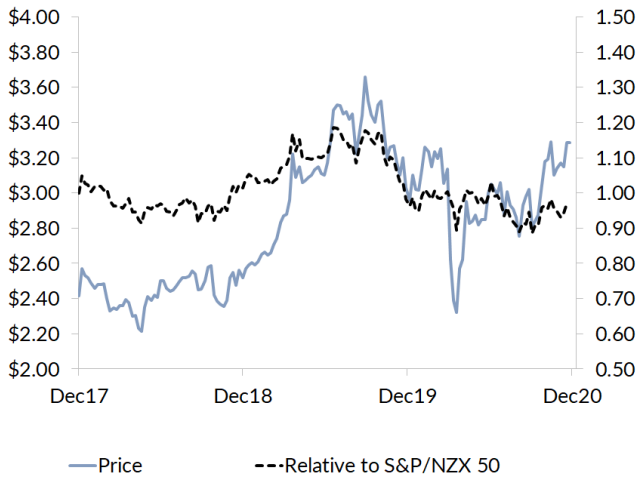
Note: FCF proxy is EBITDAF, less capex, interest and tax. The net debt/EBITDAF metric does not adjust for equity credit adjustments

NZ gas fields and field owners

Figure 5. Nine largest NZ gas fields and field owners

	Market Cap. (NZ\$b)	Kapuni	Mangahewa	Turangi	McKee	Kupe	Pohokura	Maui	Ngatoro	Kowhai	Total/ share of prod.	Total/ share of reserves
Field production (2017-2019 avg) (PJ)		8	34	10	2	25	64	28	1	4	177	
Share of NZ gas production		5%	19%	6%	1%	14%	36%	16%	1%	2%	100%	
Remaining 2P gas & LPG reserves (PJ)		197	450	343	55	286	498	142	18	22		2,011
Share of NZ reserves		10%	22%	17%	3%	14%	24%	7%	1%	1%		98%
Field ownership												
Todd Energy	n/a	100%	100%		100%		26%				34%	41%
OMV	16.9						74%	100%			43%	25%
Genesis Energy	3.4					46%					7%	6%
Beach Energy	4.3					50%					7%	7%
NZ Oil & Gas	0.1					4%					1%	1%
Greymouth Petroleum	n/a			100%					100%	100%	9%	19%

Source: MBIE, Energy News, Forsyth Barr analysis

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	51.8%

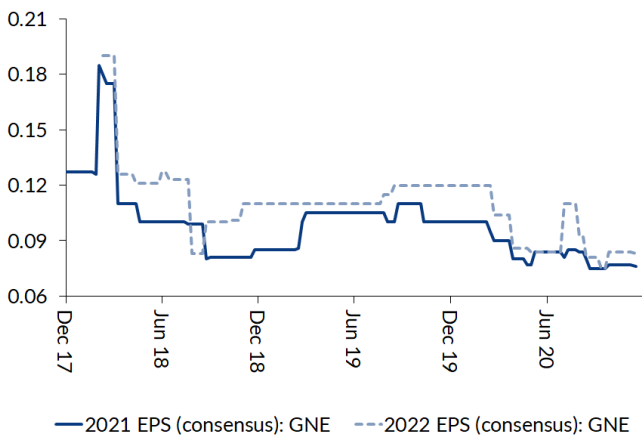
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

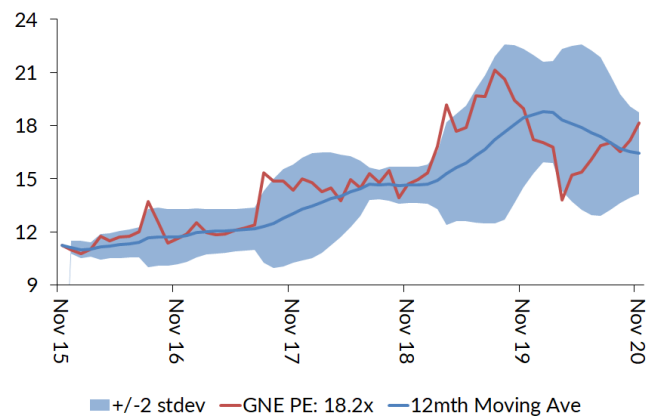
Company (metrics re-weighted to reflect GNE's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Genesis Energy	GNE NZ	NZ\$3.29	NZ\$3,428	18.2x	18.1x	11.6x	12.5x	24.8x	30.8x	4.3%
CONTACT ENERGY *	CEN NZ	NZ\$7.66	NZ\$5,504	22.2x	27.4x	14.1x	16.5x	31.1x	38.9x	4.2%
MERIDIAN ENERGY *	MEL NZ	NZ\$6.12	NZ\$15,683	35.2x	40.9x	22.4x	25.6x	37.4x	46.4x	2.8%
MERCURY *	MCY NZ	NZ\$6.05	NZ\$8,242	31.3x	33.4x	18.7x	19.0x	33.6x	35.3x	2.8%
TRUSTPOWER *	TPW NZ	NZ\$7.56	NZ\$2,366	28.7x	30.3x	15.6x	15.8x	20.4x	21.0x	4.0%
AGL ENERGY	AGLAT	A\$14.15	A\$8,816	14.3x	17.8x	6.4x	7.2x	11.0x	13.6x	5.5%
ORIGIN ENERGY	ORG AT	A\$5.31	A\$9,352	23.6x	16.3x	6.5x	5.8x	23.4x	18.1x	4.4%
Compco Average:				25.9x	27.7x	14.0x	15.0x	26.2x	28.9x	3.9%
GNE Relative:				-30%	-35%	-17%	-17%	-5%	6%	8%

EV = Current Market Cap + Actual Net Debt

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

Figure 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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