

Origin Energy

First-quarter FY20 production report

Origin Energy (ORG) delivered its September-quarter production report and in this note Ord Minnett provides a summary of the key points from the release.

Liquefied natural gas (LNG) production was below our estimate, although this was offset by higher domestic sales volumes due to seasonal demand and the restart of the Darling Downs Power Station after a planned outage. Furthermore, both domestic gas and LNG prices were above our estimate, which resulted in higher than expected revenue for the quarter.

Energy Markets data showed a soft quarter driven by milder than usual winter weather conditions.

We have increased FY20 net profit forecast by 3%, although our longer-dated estimates and valuation remain unchanged.

We maintain our Hold recommendation on Origin with an \$8.25 target price.

- **1Q20 production** – Total upstream production for the quarter of 66.5 petajoules (PJ) was 4% higher than the previous quarter. This was attributed to higher well availability and the Eurombah Reedy Creek InterConnect (ERIC) pipeline coming online.
- **LNG** – Origin’s share of LNG production increased 4% from the previous quarter to 829,000t. This implies the plant operated at an annualised rate of 8.8Mt, or a utilisation rate of 98%. 18PJ was sold into domestic markets, in line with the previous quarter but above our estimate of 15PJ. This was driven mainly by strong seasonal demand as well as the Darling Downs Power Station coming back online.
- **Realised prices** – LNG realised prices increased marginally to US\$9.67 per million British thermal units (mmBtu), implying an effective slope of 13.4% versus trailing Japanese customs-cleared crude (JCC). This compares to PNG LNG at US\$9.44/mmBtu, Santos’s (STO, Hold) portfolio at US\$10.04/mmBtu, North West Shelf at US\$7.10/mmBtu, Pluto LNG at US\$9.40/mmBtu, and Wheatstone LNG at US\$8.70/mmBtu. Management noted LNG spot prices remained weak in the quarter, driven by additional supply from new projects and subdued demand growth. Domestic gas prices fell 3% (but were above our forecast), due to lower short-term contract prices.

Recommendation

Hold

Risk

Higher

Target price

\$8.25

Last price

\$7.87

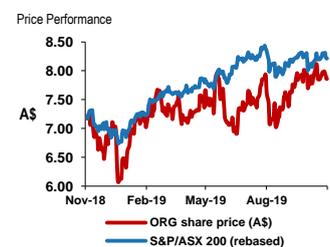


Table 1: Quarterly production summary

		Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	OMLe	QoQ	YoY	vs OMLE
Production										
LNG	000t	767	844	834	800	829	893	4%	8%	-7%
Sales										
Natural Gas	PJ	21	18	16	18	18	15	-1%	-15%	17%
LNG	000t	762	839	862	794	812	893	2%	7%	-9%
Total	PJe	63.6	64.2	63.4	62.3	63.1	65.0	1%	-1%	-3%
Realised price										
Natural Gas	\$/GJ	5.29	5.10	4.80	4.89	4.76	4.32	-3%	-10%	10%
LNG	US\$/mmBtu	9.63	10.59	10.84	9.31	9.67	9.29	4%	0%	4%
Revenue										
Natural Gas	\$m	113	90	75	89	86	67	-4%	-24%	29%
LNG	\$m	527	651	689	554	602	611	9%	14%	-2%
Total		640	741	764	643	688	678	7%	7%	1%

Source: Company reports and Ord Minnett estimates.

Price Performance

Company Data

Shares O/S (mn)	1,749
52-week range (\$)	8.14-6.03
Market cap (\$ mn)	9,412.52
Exchange rate	1.46
Free float(%)	99.3%
3M - Avg daily vol (mn)	6.09
3M - Avg daily val (\$ mn)	32.0
Volatility (90 Day)	23
Index	ASX 100
BBG BUY HOLD SELL	10 3 0

Key Metrics (FYE Jun)

\$ in millions	FY19A	FY20E	FY21E	FY22E
Financial Estimates				
Revenue	14,727	14,511	14,005	14,434
Adj. EBITDA	3,232	3,412	3,622	3,401
Adj. EBIT	1,308	1,573	1,791	1,707
Adj. net income	1,028	1,160	1,389	1,286
Adj. EPS	0.58	0.66	0.79	0.73
BBG EPS	0.59	0.59	0.62	-
Cashflow from operations	1,325	658	1,078	1,094
FCFF	1,273	264	997	1,040
Margins and Growth				
Revenue growth	0.8%	(1.5%)	(3.5%)	3.1%
EBITDA margin	21.9%	23.5%	25.9%	23.6%
EBITDA growth	9.7%	5.6%	6.1%	(6.1%)
EBIT margin	8.9%	10.8%	12.8%	11.8%
Net margin	7.0%	8.0%	9.9%	8.9%
Adj. EPS growth	22.5%	13.2%	19.7%	(7.4%)
Ratios				
Adj. tax rate	10.7%	15.8%	14.2%	16.0%
Interest cover	21.0	17.4	21.0	19.2
Net debt/Equity	0.5	0.4	0.3	0.2
Net debt/EBITDA	1.9	1.6	1.2	1.1
ROCE	4.8%	5.7%	7.1%	6.9%
ROE	8.2%	8.6%	9.8%	8.6%
Valuation				
FCFF yield	9.2%	1.9%	7.2%	7.6%
Dividend yield	3.2%	3.1%	5.0%	4.7%
EV/EBITDA	6.2	5.7	5.1	5.1
Adj. P/E	13.4	11.9	9.9	10.7

Summary Investment Thesis and Valuation

While the majority of earnings and valuation comes from the retail business, the company is highly levered to oil prices through APLNG. We expect to see earnings growth from higher cash flows from APLNG. We also expect the company's balance sheet to withstand a sustained period of low prices, with the balance sheet delevering rapidly. The company has recently announced a 20cps base dividend.

However, with the stock price trading in line with our NPV, we are Hold on the stock.

DCF valuation – June 2020

\$m	Base case
Energy Markets	
Natural gas	4,488
Electricity	7,950
Non-commodity	1,052
LPG	871
Other	-673
Rehabilitation	-364
Total	13,324
AP LNG	
Origin share	8,044
Corporate costs	-958
Enterprise value	20,410
Net cash (debt)	-5,417
Equity value	14,992
Per share (\$)	8.26

Source: Ord Minnett estimates.

Performance Drivers

Market	43%
Sector	27%
Macro	3%
Style	2%
Idiosyn.	26%

Factors	6M Corr	1Y Corr
Market: MSCI Australia	0.51	0.66
Sect: Energy	0.66	0.70
Ind: Energy	0.67	0.69
Macro:		
Crude Oil	0.35	0.47
TR/CC CRB ER Index	0.20	0.44
Economic Surprise	0.43	0.20
Quant Styles:		
Growth	-0.03	0.24
LowVol	-0.19	-0.13
Momentum	0.09	0.05

Sources for: Performance Drivers – Bloomberg, Ord Minnett Quantitative and Derivatives Strategy; all other tables are company data and Ord Minnett estimates.

Investment Thesis, Valuation and Risks

Origin Energy (Hold; Price Target: \$8.25)

Investment Thesis

While the majority of earnings and valuation comes from the retail business, the company is highly levered to oil prices through APLNG. We expect to see earnings growth from higher cash flows from APLNG. We also expect the company's balance sheet to withstand a sustained period of low prices, with the balance sheet deleveraging rapidly. The company has recently announced a 20cps base dividend. However, with the stock price trading in line with our estimate of NPV, we are Hold on the stock.

Valuation

Our June 2020 price target is based on our sum-of-the-parts valuation. In our analysis, we use a post-tax WACC of 8.3% (cost of equity 10.0%, cost of debt 8.5%).

DCF valuation – June 2020

\$m	Base case
Energy Markets	
Natural gas	4,488
Electricity	7,950
Non-commodity	1,052
LPG	871
Other	-673
Rehabilitation	-364
Total	13,324
AP LNG	
Origin share	8,044
Corporate costs	-958
Enterprise value	20,410
Net cash (debt)	-5,417
Equity value	14,992
Per share (\$)	8.26

Source: Ord Minnett estimates.

Risks to Rating and Price Target

The key upside and downside risks to our valuation are: higher or lower-than-expected oil prices; management failing to deliver on cost-out and debt reduction initiatives; weakness in NEM electricity demand; higher or lower-than-forecast electricity and gas retail tariffs; and strong cash generation leading to capital returns.

Private Client Research

Origin Energy

\$ in millions, year end Jun

Profit And Loss	FY18	FY19	FY20E	FY21E	FY22E	Valuation Summary					
						\$m	\$ps				
Revenue	14,604	14,727	14,511	14,005	14,434	Current mkt capitalisation	13,712.16	7.84			
Revenue growth	3.5%	0.8%	(1.5%)	(3.5%)	3.1%	Price Target		8.25			
COGS	-	-	-	-	-	Capital growth to price target		5.2%			
Operating Expenses	(11,657)	(11,495)	(11,099)	(10,383)	(11,033)						
EBITDA	2,947	3,232	3,412	3,622	3,401						
EBITDA growth	16.5%	9.7%	5.6%	6.1%	(6.1%)	Trading Multiples	FY18	FY19	FY20E	FY21E	FY22E
EBITDA margin	20.2%	21.9%	23.5%	25.9%	23.6%	PE Pre-abnormals	16.4	13.4	11.9	9.9	10.7
Amortisation	0	0	0	0	0	PE Reported	63.2	11.4	11.9	9.9	10.7
Depreciation	(1,573)	(1,924)	(1,839)	(1,831)	(1,693)	EV/EBITDA	7.2	6.2	5.7	5.1	5.1
EBIT	1,374	1,308	1,573	1,791	1,707	EV/EBIT	15.4	15.3	12.3	10.2	10.3
Other Income	-	-	-	-	-						
Other Expenses	-	-	-	-	-	Key Ratios	FY18	FY19	FY20E	FY21E	FY22E
Net Interest	(271)	(154)	(196)	(173)	(177)	Dividend Yield	0.0%	3.2%	3.1%	5.0%	4.7%
Pre-Tax Profit	1,103	1,154	1,377	1,618	1,530	Franking	0.0%	100.0%	100.0%	100.0%	100.0%
Tax	(262)	(123)	(217)	(230)	(245)	Return on Assets (%)	3.4%	4.1%	4.7%	5.8%	5.4%
Tax Rate	23.8%	10.7%	15.8%	14.2%	16.0%	Return on Equity (%)	7.2%	8.2%	8.6%	9.8%	8.6%
Minorities	(3)	(3)	0	0	0	ROIC (%)	-	-	-	-	-
Abnormals (post tax)	(620)	183	0	0	0						
Reported NPAT	218	1,211	1,160	1,389	1,286	Leverage	FY18	FY19	FY20E	FY21E	FY22E
Normalised NPAT	838	1,028	1,160	1,389	1,286	Gearing (Net Debt / Equity)	0.6	0.5	0.4	0.3	0.2
Growth	52.4%	22.7%	12.8%	19.7%	(7.4%)	Gearing (ND / (ND + E))	38.1%	31.5%	28.1%	23.2%	19.1%
End of Period Shares	1,758	1,760	1,754	1,754	1,754	Net Debt / EBITDA	2.5	1.9	1.6	1.2	1.1
EFPOWA	1,758	1,760	1,754	1,754	1,754	EBIT Interest Cover (x)	5.1	8.5	8.0	10.4	9.6
Reported EPS	0.12	0.69	0.66	0.79	0.73	Balance Sheet	FY18	FY19	FY20E	FY21E	FY22E
Normalised EPS	0.58	0.58	0.66	0.79	0.73	Cash	150	1,546	150	150	150
Growth	85.0%	0.9%	13.2%	19.7%	(7.4%)	Receivables	2,537	2,324	2,213	2,146	2,232
DPS	0.00	0.25	0.24	0.39	0.37	Investments	-	-	-	-	-
Growth	-	-	(4.0%)	62.5%	(5.1%)	Inventories	196	137	220	211	220
DPS/EPS payout	0.0%	36.3%	36.3%	49.3%	50.5%	Other Current Assets	883	1,156	1,156	1,156	1,156
						Total Current Assets	3,766	5,163	3,739	3,664	3,757
						Net PPE	3,696	3,597	3,522	3,339	3,118
						Total Intangibles	5,328	5,381	5,381	5,381	5,381
						Other Non Current Assets	11,467	11,602	11,394	11,398	11,403
						Total Non Current Assets	20,491	20,580	20,297	20,117	19,903
						Total Assets	24,257	25,743	24,036	23,781	23,660
						Creditors	2,011	2,210	1,831	1,762	1,831
						Current Borrowings	1,089	948	0	0	0
						Current Tax Provisions	-	-	-	-	-
						Other Current Provisions	53	45	45	45	45
						Other Current Liabilities	1,296	1,064	1,064	1,064	1,064
						Total Current Liabilities	4,449	4,267	2,940	2,871	2,940
						Non Current Creditors	-	-	-	-	-
						Non Current Borrowings	6,350	6,648	5,567	4,571	3,763
						Deferred Tax Liabilities	0	0	0	0	0
						Other Non Current Provisions	361	527	527	527	527
						Other Non Current Liabilities	1,269	1,152	1,150	1,150	1,150
						Total Non Current Liabilities	7,980	8,327	7,244	6,248	5,440
						Total Liabilities	12,429	12,594	10,184	9,119	8,379
						Equity	7,150	7,125	7,125	7,125	7,125
						Other Equity	0	0	0	0	0
						Reserves	629	1,089	1,089	1,089	1,089
						Retained Profits	4,025	4,915	5,618	6,428	7,047
						Outside Equity Interests	24	20	20	20	20
						Total Shareholders Equity	11,828	13,149	13,852	14,662	15,281
						Net Debt	7,289	6,050	5,417	4,421	3,613

Source: Company reports and Ord Minnett estimates.

Please contact your Ord Minnett Adviser for further information on our document.

Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

Ord Minnett Offices

Adelaide
Level 5
100 Pirie Street
Adelaide SA 5000
Tel: (08) 8203 2500
Fax: (08) 8203 2525

Brisbane
Level 31
10 Eagle Street
Brisbane QLD 4000
Tel: (07) 3214 5555
Fax: (07) 3214 5550

Buderim
Sunshine Coast
1/99 Burnett Street
Buderim QLD 4556
Tel: (07) 5430 4444
Fax: (07) 5430 4400

Canberra
101 Northbourne Avenue
Canberra ACT 2600
Tel: (02) 6206 1700
Fax: (02) 6206 1720

Gold Coast
Level 7, 50 Appel Street
Surfers Paradise QLD 4217
Tel: (07) 5557 3333
Fax: (07) 5557 3377

Mackay
45 Gordon Street
Mackay QLD 4740
Tel: (07) 4969 4888
Fax: (07) 4969 4800

Melbourne
Level 7
161 Collins Street
Melbourne VIC 3000
Tel: (03) 9608 4111
Fax: (03) 9608 4142

Newcastle
426 King Street
Newcastle NSW 2300
Tel: (02) 4910 2400
Fax: (02) 4910 2424

Head Office
Sydney
Level 8, NAB House
255 George Street
Sydney NSW 2000
Tel: (02) 8216 6300
Fax: (02) 8216 6311
www.ords.com.au

International
Hong Kong
1801 Ruttonjee House
11 Duddell Street
Central, Hong Kong
Tel: +852 2912 8980
Fax: +852 2813 7212
www.ords.com.hk

Disclosure: Ord Minnett is the trading brand of Ord Minnett Limited ABN 86 002 733 048, holder of AFS Licence Number 237121, and an ASX Market Participant. Ord Minnett Limited and/or its associated entities, directors and/or its employees may have a material interest in, and may earn brokerage from, any securities referred to in this document, or may provide services to the company referred to in this report. This document is not available for distribution outside Australia, New Zealand and Hong Kong and may not be passed on to any third party or person without the prior written consent of Ord Minnett Limited. Further, Ord Minnett and/or its affiliated companies may have acted as manager or co-manager of a public offering of any such securities in the past three years. Ord Minnett and/or its affiliated companies may provide or may have provided corporate finance to the companies referred to in the report.

Ord Minnett and associated persons (including persons from whom information in this report is sourced) may do business or seek to do business with companies covered in its research reports. As a result, investors should be aware that the firm or other such persons may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

This document is current as at the date of the issue but may be superseded by future publications. You can confirm the currency of this document by checking Ord Minnett's internet site.

Disclaimer: Ord Minnett Limited believes that the information contained in this document has been obtained from sources that are accurate, but has not checked or verified this information. Except to the extent that liability cannot be excluded, Ord Minnett Limited and its associated entities accept no liability for any loss or damage caused by any error in, or omission from, this document. This document is intended to provide general financial product advice only, and has been prepared without taking account of your objectives, financial situation or needs, and therefore before acting on advice contained in this document, you should consider its appropriateness having regard to your objectives, financial situation and needs. If any advice in this document relates to the acquisition or possible acquisition of a particular financial product, you should obtain a copy of and consider the Product Disclosure Statement prospectus or other disclosure material for that product before making any decision. Investments can go up and down. Past performance is not necessarily indicative of future performance.

Analyst Certification: The analyst certifies that: (1) all of the views expressed in this research accurately reflect their personal views about any and all of the subject securities or issuers; (2) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed herein.

Ord Minnett Hong Kong: This document is issued in Hong Kong by Ord Minnett Hong Kong Limited, CR Number 1792608, which is licensed by the Securities and Futures Commission (CE number BA183) for Dealing in Securities (Type 1 Regulated Activity) and Advising on Securities (Type 4 Regulated Activity) in Hong Kong. Ord Minnett Hong Kong Limited believes that the information contained in this document has been obtained from sources that are accurate, but has not checked or verified this information. Except to the extent that liability cannot be excluded, Ord Minnett Hong Kong Limited and its associated entities accept no liability for any loss or damage caused by any error in, or omission from, this document. This document is directed at Professional Investors (as defined under the Securities and Futures Ordinance of Hong Kong) and is not intended for, and should not be used by, persons who are not Professional Investors. This document is provided for information purposes only and does not constitute an offer to sell (or solicitation of an offer to purchase) the securities mentioned or to participate in any particular trading strategy. The investments described have not been, and will not be, authorized by the Hong Kong Securities and Futures Commission.

For summary information about the qualifications and experience of the Ord Minnett Limited research service, please visit <http://www.ords.com.au/our-team-2/>

For information regarding Ord Minnett Research's coverage criteria, methodology and spread of ratings, please visit <http://www.ords.com.au/methodology/>

For information regarding any potential conflicts of interest and analyst holdings, please visit <http://www.ords.com.au/methodology/>

The analyst has certified that they were not in receipt of inside information when preparing this report, whether or not it contains company recommendations. Any reports in this publication tagged as 'Private Client Research' have been authorised for distribution by Simon Kent-Jones, Head of Private Client Research at Ord Minnett Limited. Any other reports in this publication have been authorised for distribution by Nicholas McGarrigle, Head of Institutional Research at Ord Minnett Limited.