

# Genesis Energy

## Mild COVID-19 Symptoms

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### OUTPERFORM

Whilst the electricity sector is facing some COVID-19 headwinds, they are relatively minor and their earnings impact on Genesis Energy (GNE) EBITDAF is largely offset by a set of strong 3Q20 operating statistics. With the impact of COVID-19 and subsequent economic downturn expected to be minor relative to other sectors, we expect the electricity sector to benefit from the lower interest rate environment. We have increased our target multiples and lowered our target dividend yield, resulting in a modest increase (+15cps to \$3.30) in our target price. We retain our OUTPERFORM rating.

#### Figure 1. What's changed

<b>FY20/FY21 EBITDAF:</b>	Lowered -\$7m/- \$1m (-2.0%/-0.1%) to \$359m/\$404m respectively
<b>Target price:</b>	Increased +15cps (+4.8%) to \$3.30

NZX Code	GNE	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.86	NPAT* (NZ\$m)	165.0	158.3	198.2	236.2	EV/EBITDA	11.3	11.7	10.4	9.7
Target price	NZ\$3.30	EPS* (NZc)	16.1	15.3	18.8	22.3	EV/EBIT	24.2	31.7	24.8	23.0
Risk rating	Low	EPS growth* (%)	26.3	-5.3	23.3	18.3	PE	17.7	18.7	15.2	12.8
Issued shares	1037.4m	DPS (NZc)	17.1	17.2	17.5	17.8	Price / NTA	1.6	1.7	1.8	1.9
Market cap	NZ\$2,967m	Imputation (%)	80	90	95	90	Cash div yld (%)	6.0	6.0	6.1	6.2
Avg daily turnover	543.7k (NZ\$1,698k)	*Based on normalised profits					Gross div yld (%)	7.8	8.1	8.4	8.4

#### Hydro impacts FY20, but strong 3Q20 operating statistics point to retail tailwinds that will help in FY21

GNE posted strong 3Q20 operating statistics, with retail sales volumes and retail margins all increasing. However, GNE lowered its FY20 EBITDAF guidance range -\$5m to between \$355m to \$365m, citing lower hydro generation volumes as the main issue. Our forecast changes are relatively minor, with FY20/FY21 EBITDAF down -2.0% and -0.1% respectively. The main factors impacting FY20 are lower hydro generation, lower oil prices offset by a low LWAP/GWAP ratio, higher than expected retail margins and retail sales volumes across all products. FY21 is also impacted by lower oil prices, and increased bad debts but benefits from the improved retail margins. More detail of sector-side changes can be found in the May 2020 edition of Power Points.

#### Low oil price outlook a minor headwind

Whilst the fall in oil prices is a negative for GNE, its exposure to oil prices is relatively minor. In the short-term it has oil price and currency hedging in place for ~60% of expected production over the next 12 months and ~40% for the 12 months after that. In addition, oil revenue has been declining steadily as the field declines, and forecast FY20 and FY21 oil revenue is only \$26m vs. ~\$120m for gas and LPG.

#### Lifting sector outlook as defensive nature of electricity is increasingly attractive

Whilst our near-term earnings outlook is slightly softer, we believe that the electricity sector is becoming increasingly attractive relative to other market opportunities. Thinking beyond COVID-19, we expect investments that offer a robust dividend will be sought after. Traditional stocks that were previously viewed as safe havens, such as property, SkyCity and airports, face greater downside issues than the electricity stocks. We have, therefore, lowered our target gross dividend yield (-0.25% to 6.25%) and lifted our target multiples modestly (adjusted PE up +2x to 24.5x), lifting our target price +15cps (+4.8%) to \$3.30.

**Genesis Energy Limited (GNE)**

Priced as at 06 May 2020 (NZ\$)

**2.86**

<b>12-month target price (NZ\$)*</b>						<b>Spot valuations (NZ\$)</b>					
Expected share price return						1. DCF					2.80
Net dividend yield						2. Market multiple					3.37
Estimated 12-month return						3. Dividend yield					3.72
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>					
Risk free rate						Total firm value					4,272
Equity beta						(Net debt)/cash					(1,308)
WACC						Less: Capitalised operating leases					
Terminal growth						Value of equity					2,964
<b>Profit and Loss Account (NZ\$m)</b>						<b>Valuation Ratios</b>					
Sales revenue	2,304.5	3,410.0	3,229.0	3,104.4	3,130.7	EV/EBITDA (x)	11.6	11.3	11.7	10.4	9.7
<b>Normalised EBITDA</b>	<b>360.5</b>	<b>369.5</b>	<b>358.7</b>	<b>404.3</b>	<b>432.5</b>	EV/EBIT (x)	26.9	24.2	31.7	24.8	23.0
Depreciation and amortisation	(205.7)	(196.5)	(225.6)	(234.4)	(249.6)	PE (x)	22.4	17.7	18.7	15.2	12.8
<b>Normalised EBIT</b>	<b>154.8</b>	<b>173.0</b>	<b>133.1</b>	<b>169.9</b>	<b>182.9</b>	Price/NTA (x)	1.8	1.6	1.7	1.8	1.9
Net interest	(74)	(73)	(71)	(65)	(59)	Free cash flow yield (%)	5.4	5.6	6.0	7.7	8.4
Associate income	0	0	0	0	0	Net dividend yield (%)	5.9	6.0	6.0	6.1	6.2
Tax	(22)	(27)	(17)	(30)	(35)	Gross dividend yield (%)	7.7	7.8	8.1	8.4	8.4
Depreciation capex adjustment	71	92	113	122	147						
<b>Adjusted normalised NPAT</b>	<b>129</b>	<b>165</b>	<b>158</b>	<b>198</b>	<b>236</b>	<b>Capital Structure</b>					
Abnormals/other	(109)	(100)	(120)	(122)	(147)	Interest cover EBIT (x)	1.4	2.2	1.8	2.6	3.1
<b>Reported NPAT</b>	<b>20</b>	<b>65</b>	<b>39</b>	<b>76</b>	<b>89</b>	Interest cover EBITDA (x)	4.9	5.0	5.1	6.3	7.3
Normalised EPS (cps)	12.8	16.1	15.3	18.8	22.3	Net debt/ND+E (%)	37.7	36.8	37.6	37.1	36.4
DPS (cps)	16.9	17.1	17.2	17.5	17.8	Net debt/EBITDA (x)	3.3	3.4	3.5	2.9	2.5
<b>Growth Rates</b>						<b>Key Ratios</b>					
Revenue (%)	18.1	48.0	-5.3	-3.9	0.8	Return on assets (%)	2.4	3.5	2.8	4.0	4.5
EBITDA (%)	5.9	2.5	-2.9	12.7	7.0	Return on equity (%)	3.0	3.4	2.2	3.8	4.6
EBIT (%)	-2.0	11.8	-23.1	27.7	7.6	Return on funds employed (%)	3.6	3.7	2.9	3.9	4.4
Normalised NPAT (%)	-18.9	28.2	-4.1	25.2	19.1	EBITDA margin (%)	15.6	10.8	11.1	13.0	13.8
Normalised EPS (%)	-19.6	26.3	-5.3	23.3	18.3	EBIT margin (%)	6.7	5.1	4.1	5.5	5.8
Ordinary DPS (%)	1.8	0.9	1.0	1.6	1.7	Capex to sales (%)	4.7	2.0	2.1	2.1	1.8
						Capex to depreciation (%)	52	35	31	28	23
						Imputation (%)	80	80	90	95	90
						Pay-out ratio (%)	132	106	113	93	80
<b>Cash Flow (NZ\$m)</b>						<b>Operating Performance</b>					
<b>EBITDA</b>	<b>360.5</b>	<b>369.5</b>	<b>358.7</b>	<b>404.3</b>	<b>432.5</b>	Renewable generation	3,084	2,835	2,515	2,806	2,724
Working capital change	32.7	(27.3)	(2.4)	4.2	(4.6)	Gas generation	3,392	2,586	2,951	2,787	2,787
Interest & tax paid	(119.8)	(123.1)	(101.8)	(115.9)	(122.5)	Coal generation	657	1,410	1,211	876	876
Other	(6.9)	15.1	(7.4)	0	0	<b>Total GNE generation (GWh)</b>	<b>7,133</b>	<b>6,831</b>	<b>6,677</b>	<b>6,469</b>	<b>6,388</b>
<b>Operating cash flow</b>	<b>266.5</b>	<b>234.2</b>	<b>247.1</b>	<b>292.7</b>	<b>305.4</b>	GWAP (\$/MWh)	92	143	98	87	87
Capital expenditure	(107.7)	(68.5)	(69.3)	(64.5)	(57.0)	<b>Retail electricity</b>					
(Acquisitions)/divestments	0.3	(0.2)	(2.9)	0	0	Electricity customers (000)	504	499	492	488	485
Other	0	0	0	0	0	MM/SME volumes	4,169	4,077	4,140	4,056	4,034
<b>Funding available/(required)</b>	<b>159.1</b>	<b>165.5</b>	<b>174.9</b>	<b>228.2</b>	<b>248.4</b>	TOU volumes	1,811	1,992	2,037	2,058	2,078
Dividends paid	(147.7)	(131.6)	(138.6)	(142.9)	(167.1)	<b>Total fixed price volumes (GWh)</b>	<b>5,980</b>	<b>6,068</b>	<b>6,177</b>	<b>6,113</b>	<b>6,113</b>
Equity raised/(returned)	(1.1)	(1.3)	(0.1)	0	0	Average MM usage/cust (kWh/yr)	8,240	8,126	8,333	8,276	8,305
<b>(Increase)/decrease in net debt</b>	<b>10.3</b>	<b>32.6</b>	<b>36.2</b>	<b>85.3</b>	<b>81.3</b>	Average FPV price (\$/MWh)	206	210	213	209	211
						LWAP (\$/MWh)	92	139	95	87	88
						LWAP/GWAP	1.01	0.97	0.97	1.01	1.01
						Line losses (%)	5.3	5.4	5.6	5.6	5.6
						<b>Kupe production</b>					
						Gas production (PJ)	11.8	11.8	10.9	11.4	12.2
						Oil production (k barrels)	532.8	472.9	382.7	387.1	571.2
						LPG production (k tonnes)	45.9	50.6	47.7	50.4	54.4
<b>Balance Sheet (NZ\$m)</b>						<b>Kupe EBITDAF (\$m)</b>					
Working capital	89.8	111.8	102.5	98.3	102.9	Energy EBITDAF (\$m)	245.2	260.5	264.2	303.5	306.5
Fixed assets	3,430.0	3,773.1	3,651.7	3,501.9	3,317.3	<b>GNE EBITDAF (\$m)</b>	<b>360.6</b>	<b>369.5</b>	<b>358.7</b>	<b>404.3</b>	<b>432.5</b>
Intangibles	364.3	364.0	357.9	353.6	347.5						
Right of use asset	0	0	0	0	0						
Other assets	84.0	120.8	122.8	122.8	122.8						
<b>Total funds employed</b>	<b>3,968.1</b>	<b>4,369.7</b>	<b>4,235.0</b>	<b>4,076.6</b>	<b>3,890.6</b>						
Net debt/(cash)	1,206.1	1,293.1	1,282.4	1,212.9	1,133.6						
Lease liability	0	0	0	0	0						
Other liabilities	805.6	931.6	896.4	874.6	846.1						
Shareholder's funds	1,956.4	2,145.0	2,056.1	1,989.1	1,910.9						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>3,968.1</b>	<b>4,369.7</b>	<b>4,235.0</b>	<b>4,076.6</b>	<b>3,890.6</b>						

## 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	3,183	3,083	-3%	3,085	2,950	-4%	3,010	2,947	-2%
Kupe revenue	150	146	-3%	160	154	-4%	188	184	-2%
<b>Total revenue</b>	<b>3,334</b>	<b>3,229</b>	<b>-3%</b>	<b>3,245</b>	<b>3,104</b>	<b>-4%</b>	<b>3,198</b>	<b>3,131</b>	<b>-2%</b>
Energy operating costs	(2,916)	(2,819)	-3%	(2,787)	(2,647)	-5%	(2,703)	(2,640)	-2%
Kupe operating costs	(52)	(52)	0%	(53)	(53)	0%	(58)	(58)	0%
Energy EBITDAF	268	264	-1%	297	304	2%	307	307	0%
Kupe EBITDAF	98	94	-4%	107	101	-6%	130	126	-3%
<b>Reported EBITDAF</b>	<b>366</b>	<b>359</b>	<b>-2%</b>	<b>405</b>	<b>404</b>	<b>0%</b>	<b>437</b>	<b>433</b>	<b>-1%</b>
Depn & amort	(226)	(226)	0%	(234)	(234)	0%	(250)	(250)	0%
FV mvmts, assoc inc, other	(8)	(8)	0%	-	-		-	-	
<b>EBIT</b>	<b>132</b>	<b>125</b>	<b>-5%</b>	<b>170</b>	<b>170</b>	<b>0%</b>	<b>188</b>	<b>183</b>	<b>-2%</b>
Net interest	(71)	(71)	0%	(64)	(65)	1%	(59)	(59)	1%
<b>Pre-tax profit</b>	<b>61</b>	<b>54</b>	<b>-11%</b>	<b>106</b>	<b>105</b>	<b>-1%</b>	<b>128</b>	<b>123</b>	<b>-4%</b>
Tax	(17)	(15)	-11%	(30)	(30)	-1%	(36)	(35)	-4%
<b>NPAT</b>	<b>44</b>	<b>39</b>	<b>-11%</b>	<b>76</b>	<b>76</b>	<b>-1%</b>	<b>92</b>	<b>89</b>	<b>-4%</b>
<b>Normalised NPAT</b>	<b>51</b>	<b>46</b>	<b>-10%</b>	<b>76</b>	<b>76</b>	<b>-1%</b>	<b>92</b>	<b>89</b>	<b>-4%</b>
<b>Adjusted normalised NPAT</b>	<b>164</b>	<b>158</b>	<b>-3%</b>	<b>199</b>	<b>198</b>	<b>0%</b>	<b>231</b>	<b>228</b>	<b>-2%</b>
EPS (cps)	4.9	4.4	-10%	7.3	7.2	-1%	8.8	8.4	-5%
Adjusted EPS	15.8	15.3	-3%	19.0	18.8	-1%	22.0	21.4	-2%
Dividend (cps)	17.2	17.2	0%	17.5	17.5	0%	17.8	17.8	0%
Capex	95	95	0%	80	80	0%	59	66	12%
<b>Operating statistics</b>									
Generation (GWh)	6,655	6,677	0%	6,388	6,469	1%	6,388	6,388	0%
FPVV sales (GWh)	6,135	6,177	1%	6,135	6,113	0%	6,135	6,113	0%
Electricity customer numbers (000)	495	492	-1%	490	488	-1%	488	485	-1%
GWAP (\$/MWh)	\$114.3	\$97.9	-14%	\$108.6	\$86.5	-20%	\$96.9	\$87.0	-10%
LWAP/GWAP	0.990	0.974	-2%	1.010	1.009	0%	1.009	1.008	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 cashflow 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.

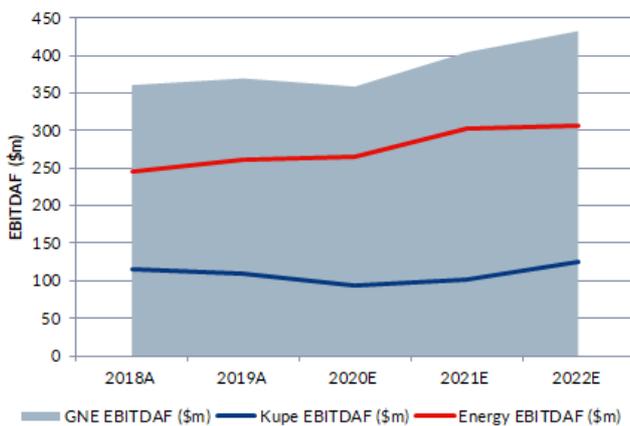
### Financial structure

- **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).

### Risk factors

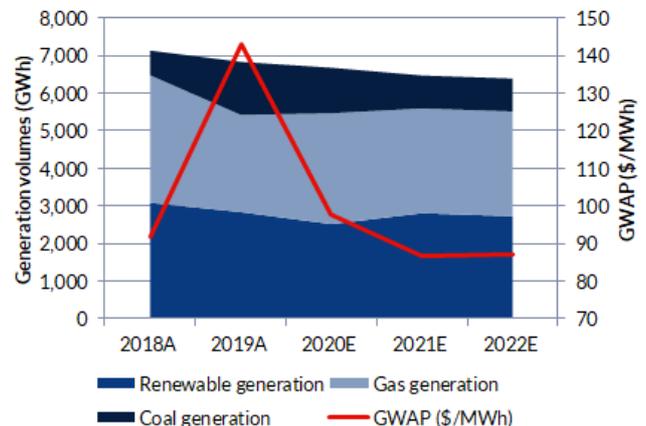
- **Increasing carbon costs:** GNE is required to relinquish an increasing value of carbon credits. Higher carbon prices combine to create financial headwinds for the next few years.
- **NZAS risk:** NZAS has indicated it is undertaking a strategic review, raising the possibility it may close. In our 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.

Figure 3. EBITDAF breakdown



Source: GNE, Forsyth Barr analysis

Figure 4. Generation volumes and average price received



Source: GNE, Forsyth Barr analysis

**Figure 5. Price performance**


Source: Forsyth Barr analysis

**Figure 6. Substantial shareholders**

Shareholder	Latest Holding
NZ Govt	51.8%

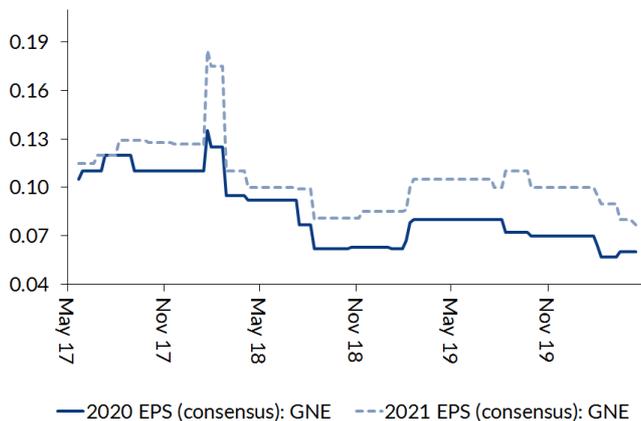
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 7. International valuation comparisons**

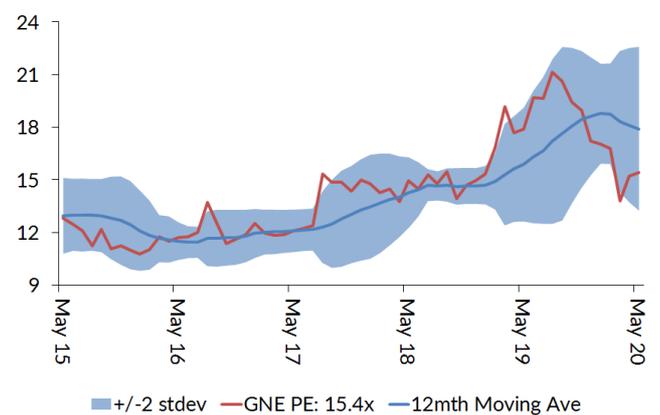
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
(metrics re-weighted to reflect GNE's balance date - June)										
Genesis Energy	GNE NZ	NZ\$2.86	NZ\$2,967	18.7x	15.2x	11.8x	10.4x	31.7x	24.8x	6.1%
Contact Energy*	CEN NZ	NZ\$6.30	NZ\$4,524	20.1x	18.5x	12.6x	11.8x	25.2x	22.8x	6.2%
Meridian Energy*	MEL NZ	NZ\$4.82	NZ\$12,354	24.7x	27.4x	15.9x	17.1x	25.1x	27.8x	4.5%
Mercury*	MCY NZ	NZ\$4.59	NZ\$6,246	26.5x	22.9x	14.6x	14.0x	24.7x	23.2x	3.5%
Trustpower*	TPW NZ	NZ\$6.32	NZ\$1,978	22.6x	19.4x	13.2x	12.1x	16.6x	14.9x	5.4%
AGL ENERGY	AGL AT	A\$17.09	A\$10,752	13.2x	13.2x	6.5x	6.5x	10.1x	10.2x	5.7%
ORIGIN ENERGY	ORG AT	A\$4.89	A\$8,612	8.5x	17.8x	4.9x	6.5x	11.4x	20.2x	3.9%
<b>Compcop Average:</b>				<b>19.3x</b>	<b>19.9x</b>	<b>11.3x</b>	<b>11.3x</b>	<b>18.9x</b>	<b>19.8x</b>	<b>4.9%</b>
<b>GNE Relative:</b>				<b>-3%</b>	<b>-24%</b>	<b>4%</b>	<b>-8%</b>	<b>68%</b>	<b>25%</b>	<b>26%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 8. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 9. One year forward PE (x)**


Source: Forsyth Barr analysis

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#### Figure 10. What's changed:

<b>FY20/FY21 EBITDAF:</b>	Lowered -\$10m/- \$10m (-2.3%/-2.2%) to \$431m/\$463m respectively
<b>Target price:</b>	Increased +15cps (+1.9%) to \$8.15