

fatPROPHETS™

1300 881 177

Genesis Energy

01/04/2014 FAT-AUS-667

GNE

1.550

Core

MED.

B

Third time's a charm

The New Zealand government has now released the final pricing details for the third and final cab off the rank in a series of sales of state owned energy companies. The latest is Genesis Energy which is New Zealand's largest electricity and gas supplier.

We previously covered both the floats of Mighty River Power and Meridian and advised sitting them out. We however believe that there are a number of important differences with the Genesis Energy float which could potentially make it a more attractive offering. We believe that the structure of the offer is more appealing with investors now having clarity on price before applying. The assets behind Genesis are also different in makeup, with more exposure to thermal energy in particular. Furthermore, the company is more diverse in terms of customer base and revenue streams.

This is the New Zealand government's last chance to get away a successful part privatisation of an energy company, and we believe that they have got more right this time around.



Pricing of the offer has been set at NZ\$1.55 a share. Whilst at the higher end of the initial indicative range we believe that the stock is an attractive investment opportunity at these levels. We are therefore recommending take up of the offer.

Note: All figures are in New Zealand Dollars, unless otherwise stated.

About Genesis

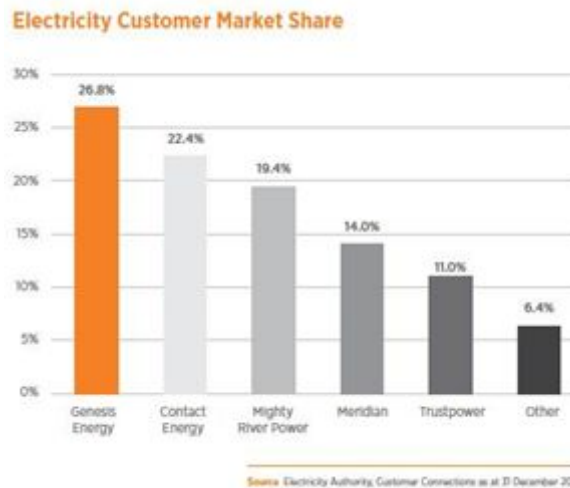
Retail

Genesis Energy is the largest of the New Zealand's electricity companies by customer numbers, with more than 650,000 connections across the country. In retail, the company supplies electricity, natural gas and LPG, operating through two brands, Genesis Energy and Energy Online.

Brand	Market	Electricity Customers	Natural Gas Customers	LPG Customers
	Nationwide brand	473,000	114,000	10,700
	Selected regions. "No frills" brand, for customers looking for service at competitive prices	67,300	1,500	-

Graphic Source: Genesis Energy Investment Statement

Genesis has the largest share of the electricity market in New Zealand with 26.8% (as at 31 December 2013). New Zealand's electricity market is competitive with a high level of customer switching (20% being the industry average) as companies offer lower prices to get customers to move. Genesis has seen a lower switching rate of 18% as it has been able to maintain more customers due to competitive pricing, a good reputation for customer service and also as it has a superior dual fuel offering (Genesis has 43.7% of the natural gas market).



Graphic Source: Genesis Energy Investment Statement

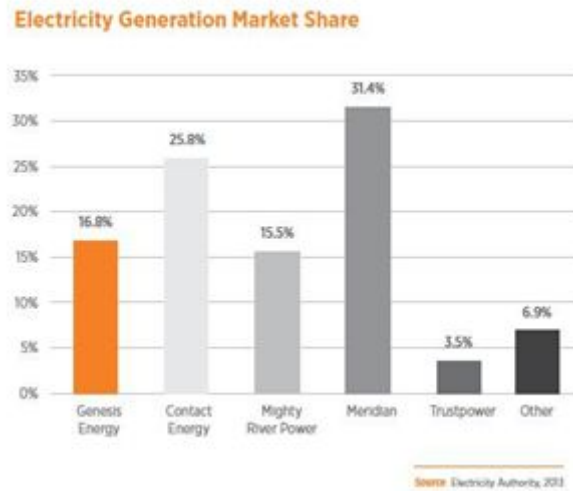
Generation

Genesis' generation assets are meanwhile somewhat more diverse (both in nature and geography) than those of the other two partially privatised electricity companies. The company owns and operates a portfolio of thermal and renewable generation assets (with 10 power stations in total) located in various parts of New Zealand.

The company also has a 1203.8 MW coal and gas station in Huntly, which is New Zealand's largest by capacity and is capable of providing 20% of New Zealand's electricity needs.

In hydro, the company has stations across the country including Tekapo in the South Island and Tongariro in the North. The geographical spread means that (unlike some competitors) it is not reliant on one catchment area or adverse weather conditions in one region.

Market share wise, Genesis supplied around 16.8% of New Zealand's electricity output in 2013. Around 32% of this was from renewable sources.



Graphic Source: Genesis Energy Investment Statement

Another differentiating factor with respect to Genesis is that it has a stake in an oil and gas field. It owns 31% of the Kupe joint venture, which holds the namesake oil and gas field in the offshore Taranaki basin. The field is expected to meet 11% of New Zealand's annual gas demand, and 50% of New Zealand's annual LPG demand, through to 2025.

Under the Kupe JV, Genesis receives a 31% share in natural gas (and rights to purchase the rest) and sells this to retail customers or uses it at the Huntly power station. It also receives 31% of LNG produced and sells it on to retail customers. Almost all of the oil produced by Kupe is exported, for which Genesis receives a 31% revenue share.

The overall contribution of Kupe to Genesis' bottom line is significant, with the asset making up just under a third of the company's underlying EBITDAF (earnings before interest, tax, depreciation, amortisation and changes in asset fair values) in full year 2013.

Financials

Genesis saw EBITDAF decrease from \$387.3 million to \$336.4 million in FY2013. This was as a result of a 15% reduction in generation volumes and wholesale electricity prices due to a return to more normal weather patterns from the year before. Wholesale electricity prices actually rose 31% in the second half (due to a drought in the North) but Genesis was not able to profit as much as it should due to a planned outage at its stations in the South.

	FY2012	FY2013	FY2014	FY2015
\$ million	Historical	Historical	Prospective	Prospective
Electricity revenue	1,923.2	1,743.9	1,691.3	1,844.1
Gas revenue	235.8	212.5	261.0	244.0
Petroleum revenue	85.8	80.5	81.3	68.3
Other revenue	20.0	33.4	7.0	9.4
Total operating revenue	2,264.8	2,070.2	2,040.6	2,165.9
Electricity purchases, transmission and distribution	(1,004.9)	(920.0)	(912.8)	(1,025.3)
Gas purchases and transmission	(249.4)	(217.2)	(257.2)	(235.4)
Petroleum production, marketing and distribution	(35.0)	(31.5)	(30.1)	(28.5)
Fuels consumed	(288.4)	(259.9)	(203.1)	(212.4)
Employee benefits	(80.8)	(83.6)	(87.0)	(85.2)
Other operating expenses	(219.0)	(221.7)	(245.2)	(215.6)
Total operating expenses	(1,877.5)	(1,733.8)	(1,735.4)	(1,802.4)
EBITDAF	387.3	336.4	305.2	363.4

Source: Genesis Energy Investment Statement

Looking ahead to FY2014, Genesis is expecting EBITDAF to decline to \$305.2 million due to lower average wholesale electricity prices, a further planned outage at Tekapo, and a hefty \$26.2 million in costs associated with the partial float. The story is somewhat brighter for 2015 with earnings set to rise back to \$363.4 million, assuming hydro inflows and weather patterns revert to normal, and with no planned outages or one off operating expenses.

Genesis Energy EBITDAF Trends



Source: Genesis Energy Investment Statement

As a consequence, bottom line net profit is set to come in \$41.8 million for the year to 30 June 2014, but is forecast to more than double to \$95.4 million in the June 2015 year.

Selected Financial Information \$million	FY2012 Historical	FY2013 Historical	FY2014 Prospective	FY2015 Prospective
Operating Revenue	\$2,264.8	\$2,070.2	\$2,040.6	\$2,165.9
EBITDAF	\$387.3	\$336.4	\$305.2	\$363.4
Net Profit	\$86.4	\$104.5	\$41.8	\$95.4
Net Assets ⁵	\$1,796.6	\$1,949.7	\$1,871.2	\$1,824.5
Net cash inflows from operating activities	\$363.3	\$298.3	\$293.3	\$344.9

Source: Genesis Energy Investment Statement

Clearly much of these forecasts will be weather dependent and, as with the other generation companies, this will always present an earnings risk.

Balance sheet wise, Genesis is solid, having paid down debt on hydro generation assets in recent years. Net debt is set to come in at \$994.3 million at 30 June 2014, and is around 53% of net tangible assets.

Overview of Consolidated Balance Sheet

\$million	As at 30 June 2012 Historical	As at 30 June 2013 Historical	As at 30 June 2014 Prospective	As at 30 June 2015 Prospective	As at 31 December 2013 Historical
Total assets	3,630.2	3,751.2	3,685.1	3,547.2	3,667.5
Total liabilities	1,833.6	1,801.5	1,813.9	1,722.8	1,757.9
Net Assets ²⁰	1,796.6	1,949.7	1,871.2	1,824.5	1,909.6
Including:					
Net Debt	994.7	1,002.2	994.3	924.4	968.3

Source: Genesis Energy Investment Statement

The Offer

The government has recently set out the terms of the partial privatisation of Genesis and has laid out a number of sweeteners to make it more attractive.

The final price for Genesis Energy has been set at \$1.55 per share which places the market capitalisation of the company at \$1.55 billion.

Unlike previous floats (and something we had an issue with), the government has performed a book build at the start of the process (rather than at the end) and has set a final exact price. Investors will be able to apply for shares from March 29th with the offer closing on April 11th. The company will list on the NZX and ASX on April 17th.

The company has also added a bonus share (up to a maximum of 2000) for every 15 shares that (New Zealand based) investors hold for a year or more post the float.

The government is also looking to ensure that the offer is well supported, and has allocated 40% of the total number of shares in Genesis through the book-build process, leaving 9% to be offered under the General offer. The government will retain a 51% holding.

Based on final pricing, Genesis looks fairly fully valued on FY2014 forecasts, trading on 37.1 times bottom line earnings. However, this improves somewhat to 16.2 times for the 2015 year as a result of the absence of one off float costs, absence of planned downtime and as a return to more normal weather patterns (should) kick in.

From an income perspective, the shares boast considerable appeal with a cash dividend yield of 8.3% for 2014, rising to 10.3% for 2015. The prospective return rises further for New Zealand residents when factoring in imputation credits with a gross yield in 2015 of up to 14.3%.

Key Investment Metrics	FY2014 Prospective	FY2015 Prospective
Price/earnings ratio	37.1x	16.2x
EV/EBITDAF multiple	8.3x	7.0x
Implied cash dividend yield [†]	8.3%	10.3%
Implied gross dividend yield [†]	11.5%	14.3%

These Key Investment Metrics are based on the Final Price. EBITDAF and Net Debt are non-GAAP financial measures. You can find further information about non-GAAP financial measures and the calculation of the Key Offer Statistics and the Key Investment Metrics in Section 5 Overview of Financial Information and the Glossary of the Investment Statement and in Section 6.0 Financial Information and the Glossary of the Prospectus.

[†] The prospective dividend for FY2014 is inclusive of the dividend expected to be paid to the Crown in April 2014. There is no assurance that prospective dividends will be paid.

Source: Genesis Energy Investment Statement (updated 28/3/14)

Looking at the terms, the offer appears quite attractive in our view.

Risks

As with the other electricity companies, Genesis faces a number of key operational and regulatory risks. Competition is one thing but by far and away the biggest operational risk is the weather which can significantly impact generation, and therefore wholesale electricity prices. Weather patterns are becoming more unpredictable it seems but Genesis can mitigate the impact on its own generating ability to some degree through its thermal assets.

The closure of Tiwai Point smelter (which consumes 13% of New Zealand's electricity) is another potential big risk. The future of the smelter has been brought into question by owner Rio Tinto.

The cost of closing Tiwai Point would not be insubstantial to Rio Tinto (several hundred million dollars) but ought not be simply dismissed on this basis. We have noted some comments that the NZ electricity market would 'simply rebalance' if Tiwai point were to close. This is a big call and would not happen overnight, and would be far from a smooth process in our view.

Another key risk follows the announcement made by the Labour Greens opposition during the Mighty River float (last April) which has not gone away. **The coalition has said they 'plan' to restructure the electricity industry if they gain power in [September] 2014.** A common part of their plan is for a single state buyer of wholesale electricity from generating companies, and ultimately reducing the end cost to retail customers.

Whilst it remains to be seen whether the parties win power (and this is looking increasingly unlikely given recent polls), and it would take time to enact, it does increase the regulatory risks facing Genesis.

There is also a further risk with the Electricity Authority reviewing its transmission pricing methodology. The results will be known later this year and if costs were to rise as a result, it is uncertain how much could be

passed through to consumers. That said, any pricing changes are unlikely to come into effect before 2016.

Summary and recommendation

Despite the operational and regulatory risks, we believe the Genesis partial float looks very attractive. The underlying assets are more diverse than those of Mighty River Power and Meridian, and we believe the offer has been structured in a more attractive manner.

Pricing of the offer has been set at \$1.55 a share. Whilst at the higher end of the initial indicative range, we believe that the stock is an attractive investment opportunity at these levels. We are therefore recommending that investors that are able to, take up the offer.

The public offer is only open to New Zealand residents. Shares can be applied for at www.genesisenergyshares.govt.nz. There is also a help line on 0800 90 30 90.

Australian residents should contact their broker to determine an ability to access the offer. Otherwise the shares as noted above will be listing both the NZX and ASX on April 17th.

DISCLAIMER

Fat Prophets has made every effort to ensure the reliability of the views and recommendations expressed in the reports published on its websites. Fat Prophets research is based upon information known to us or which was obtained from sources which we believed to be reliable and accurate at time of publication. However, like the markets, we are not perfect. This report is prepared for general information only, and as such, the specific needs, investment objectives or financial situation of any particular user have not been taken into consideration. Individuals should therefore discuss, with their financial planner or advisor, the merits of each recommendation for their own specific circumstances and realise that not all investments will be appropriate for all subscribers. To the extent permitted by law, Fat Prophets and its employees, agents and authorised representatives exclude all liability for any loss or damage (including indirect, special or consequential loss or damage) arising from the use of, or reliance on, any information within the report whether or not caused by any negligent act or omission. If the law prohibits the exclusion of such liability, Fat Prophets hereby limits its liability, to the extent permitted by law, to the resupply of the said information or the cost of the said resupply. As at the date at the top of this page, Directors and/or associates of the Fat Prophets Group of Companies currently hold positions in: ASX-listed Australian stocks: AAC, AAD, AGO, AJA, AMP, ANZ, APA, APG, AVG, BCI, BHP, BKN, BOQ, BRL, BRU, BTR, BWP, CBA, CCL, CDD, CFE, CGL, CKF, CNQ, CVO, CWN, DLS, DNQ, DUE, ELD, ENV, EVN, FID, FMG, FXJ, GJT, GMG, GNS, GOR, GPT, GXL, HUB, IAU, IFL, ILU, IMF, JHX, MFG, MGR, MML, MMS, MND, MNF, MPL, MTR, MTU, NAB, NCM, NMG, NUF, OBS, ORE, OSH, OVH, POS, PPS, PRG, PRT, PXG, QAN, QBE, RIO, RXL, RRS, S32, SDG, SFR, SGP, SIV, SLR, SPK, STO, SUN, SYD, TAM, TEN, TLS, TME, TTN, WBC, WFD, WES, WHC, WOW, WPL, WSA. International stocks 3i Group, Acacia Mining, Amec Foster Wheeler, Anglo American, Archipelago Resources, Arian Silver Corp, Aviva, Avocet Mining, Bank of China, Barratt Developments, BMW, Berkeley Energy, BG Group, BOLSAS Y MERCADOS ESPANOLESES, SOCIEDAD, Bovis Homes, BP, Braemar Shipping Group, British American Tobacco, BT Group, Cairn Energy, Centamin Egypt, China Life Insurance, China Mobile, China Overseas, China Taiping, China Vanke, Country Garden, Daejan Holdings, Development Securities, Dragon, Enquest, Esure, Euronext, FedEx, Fresnillo, Ibiden, Infosys, Glaxosmithkline, Glencore International, Goldbridges Global Resources, Google (Alphabet), Grainger, Gulf Keystone Petroleum, Highland Gold Mining, HSBC, ICICI Bank, Ironvold, iShares Physical Metals, J Sainsbury, JKX Oil & Gas, John Wood Group, Kazakhmys, Legal & General, Lloyds, Low and Bonar, Market Vectors Junior Gold Miners, Market Vectors Oil Services, Market Vectors Vietnam, Marstons, Medusa Mining, Mitchells & Butlers, Mitsubishi Tokyo Financial, Mitsubishi UFJ, National Grid, Nippon Telegraph and Telephone, Panasonic, Paragon Group of Companies, Petra Diamonds, Petrofac, Petropavlovsk, PICC Property & Casualty, PPHE Hotel Group, Randgold Resources, Rank Group, Reckitt Benckiser, Royal Dutch Shell, Solgold, Sony Corporation, Standard Chartered, STV Group, Sylvania Platinum, Tata Motors, Tencent, Tertiary Minerals, Teva Pharmaceutical, Toyota Motor, Tullow Oil, Unilever, Vedanta Resources, Vodafone, Walt Disney, Zillow.

Snapshot GNE

Genesis Energy

Latest Closing Price: \$1.55

Genesis Energy is the largest of the New Zealand's electricity companies by customer numbers, with more than 650,000 connections across the country. In retail, the company supplies electricity, natural gas and LPG, operating through two brands,

Genesis Energy and Energy Online.

Genesis' generation assets are meanwhile somewhat more diverse (both in nature and geography) than those of the other two partially privatised electricity companies. The company owns and operates a portfolio of thermal and renewable generation assets (with 10 power stations in total) located in various parts of New Zealand.

The company was partially privatised by the New Zealand government in April 2014.

Market Capitalisation:

Copyright © 2000 - 2016 Fat Prophets. All rights reserved. No portion of this website may be reproduced, copied, or in anyway reused without written permission from Fat Prophets.