Genesis Energy 14/11/2017 **FAT-AUS-848**

GNE AUD $2.46 Core **MED.** S

Fat Prophets take profits

After dipping initially in the wake of the election result in New Zealand, shares in the country's largest gentailer, Genesis Energy (ASX/NZX: GNE) have climbed higher in recent months. Renewed momentum has been aided by rising energy prices and the release of a strong first quarter performance update last month, while fears have also eased over government meddling in the sector.

We are however not so certain on the last point. Indeed, the Labour/NZ First coalition deal included plans for a full scale review of retail power pricing. No further details have emerged, and we harbour some concerns that an environmentally charged government may not deliver the most favourable of outcomes.

A de-privatisation of the electricity sector by the coalition is not likely, or affordable, given the run in the share prices of the constituents since they were floated by the last government. However, we have a wider concern over the impact of the incoming government on the New Zealand economy, and indeed stock market in the coming years. A 'spend and tax' plan in our view does not bode well for sustained economic growth, and at the very least we are likely to see interest rates and inflation ratchet to the upside. This will not in our opinion be conducive to strong investor appetite for bond-like utility plays such as Genesis Energy.

All smiles now…

Added to the fact that the shares are not exactly cheap at 30 times earnings (although downside risk is compensated by a 7% yield), we believe now is the appropriate time to exit. Genesis Energy has been a solid performer in the portfolio since it was first recommended in 2014, delivering a gain of around 90 percent including dividends.

We recommend Members sell their holdings in Genesis Energy.

From a company specific perspective, Genesis does continue to tick a number of boxes (and despite some potential macro headwinds). While the broader operating environment remains challenging due to intense competition, the company's wholesale and energy (Kupe) businesses are performing well. This was also evident in the company's first quarter update last month.

In Wholesale, total generation was up 23.2% across both thermal and renewable sources from a combination of "higher thermal at the beginning of the quarter when lake levels were low, through to higher renewable generation more recently as storage levels returned to above average conditions." The company reported that weighted average wholesale prices were up 66.2% on the prior quarter whilst plant availability initiatives had borne fruit.

At the Kupe oil & gas field, production levels were strong, with the field operating at 95.4% of maximum plant capacity. The company has lifted its stake in Kupe, which we think will a boon longer term, given our positive view on energy prices. That said, the company indicated that oil sales were down in the quarter due to a deferred shipment.

In the retail sector the company reported progress in the integration of the Nova Energy retail LPG business, with over 70% of customers being migrated, and all depots rebranded. Overall, electricity demand rose for the quarter as continued "business growth offset residential declines" with price increases across both market segments.

Customers in retail though fell by 1,101 in the quarter, and going forward we expect competition to remain high, with rivals offering switching incentives to get consumers to change their provider for what is essentially a commodity. Most of this switching activity is also happening online.

Despite our caution on the shares, the technical picture is slightly more encouraging. Structural support at the \$2.10 region as shown by the horizontal blue line was respected in October. This is actually deemed bullish price-action, and suggestive of the correction in play since July to have completed. A sustained break above resistance evident at \$2.26 (horizontal thin-red line) is required to strengthen the short-term technical outlook.

Should this occur, then momentum would once again rotate in favour of the bulls, and thus result in further gains to be had over the medium-term.

With reference to the monthly chart, support was respected at the 38.2% Fibonacci retracement of \$2.08 in October, which is a positive event. Should upward momentum lift, then a resumption of the broader uptrend is likely to follow towards resistance sighted at the \$2.46 region being the July all-time high.

Summary

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Add to the fact that the shares are not exactly cheap at 30 times earnings, we believe now is the appropriate time to exit the shares. Genesis Energy has been a solid performer in the portfolio since it was first recommended in 2014, delivering a gain of around 91 percent including dividends.

We recommend Members sell their holdings in Genesis Energy.

Snapshot GNE

Genesis Energy

Latest Closing Price: $2.46

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:$2.5b

	FY1	FY2
Price to Earnings	30.4	25.4
Dividend Yield (%)	7.0	7.0
Price to Book	1.3	1.4
Return on Equity (%)	4.2	5.3