Genex Power

Kidston solar production takes a hit

- Electricity and environmental revenue was down 27% on pcp from an outage in October and lower realised prices in the half.
- Other income was down $2.4m as the claims against UGL are mostly complete although we expect an additional claim in the second half for the October outage.
- Jemalong construction has commenced with anticipated commissioning in 2QFY21.
- We maintain our SPECULATIVE BUY rating and increase our price target to 26cps.

SPECULATIVE BUY

(no change)

Current price:	A$0.21
Target price: ▲	A$0.26
Previous target:	A$0.25
Up/downside:	26.8%
Reuters:	GNX.AX
Bloomberg:	GNX AU
Market cap:	US$54.18m
	A$82.38m
Average daily turnover:	US$0.05m
	A$0.08m
Current shares o/s	312.4m
Free float:	69.3%

Key changes in this note

FY20F revenue down by 20%.

FY20F net profit down by $8m.

FY21F net profit down by $1m.

Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-8.9	5.1	-16.3
Relative (%)	-4.1	8.1	-24.2

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Analyst(s) own shares in the following stock(s) mentioned in this report:

– Genex Power

Kidston solar outage a one off but realised price is also lower

Production in the first half suffered from an extended outage in October. An issue with inverter software meant that Kidston Stage 1 (KS1) wasn't able to export power to the grid. We understand that GNX is pursuing a claim with its contractor. The realised price in 1H was also lower against pcp and the prior half. 1H19 benefited from sales into the spot market so a drop was to be expected since all of the output has been fully contracted since 2H19. The realised price also fell against 2H19 though which was a surprise. Part of this was due to the timing of payment claims under the KS1 contract which are likely to carry over into the second half. Additionally, the costs of grid services (FCAS) were higher in 1H20 and are netted off revenues. GNX has plans to mitigate its exposure to FCAS in the future with updated automatic generation dispatch software.

Going long on Jemalong

The decision to invest in Jemalong (JSP) was taken in mid-December and capital expenditure on the project has commenced. We expect spending on Jemalong to peak this half and activity to ramp down with expected commissioning in 1H FY21. Our assessment of the value of the Jemalong project has been impacted by falling NSW spot electricity and Large-scale Generation Certificate (LGCs) prices. NSW electricity prices are expected to increase though in the medium term as the Liddell plant closes in FY22/23.

Pumped hydro – the fundamentals are still there

We see several different markets that pumped hydro (PH) storage assets can compete in. Arguably pumped hydro's best application is to shift energy between peak solar output and peak demand because of PH's typically larger storage capacity compared to batteries. Value can also be derived from the price volatility that comes with increasing renewable energy even as spot prices are lower on average. It's possible that PH assets could also compete to offer slower reaction FCAS services such as raise/lower 5 minute which adjusts system frequency and helps to maintain grid stability.

Value potential still there but it's risky

We still see value in GNX despite the weaker performance of KS1 and the more challenging conditions facing JSP. However, as our valuation is still heavily reliant on our assessment of K2-H's value we note that this is still a speculative investment. K2-H has willing backers in the Northern Australia Infrastructure Facility (NAIF) and J-Power however that value can't be realised without an offtake contract. We maintain our SPECULATIVE BUY rating and increase our target price to 26cps.

Financial Summary	Jun-18A	Jun-19A	Jun-20F	Jun-21F	Jun-22F
Revenue (A$m)	8.27	10.82	9.66	20.28	22.61
Operating EBITDA (A$m)	-1.72	5.59	2.26	14.37	16.26
Net Profit (A$m)	-7.46	-9.17	-10.87	1.05	1.36
Normalised EPS (A$)	(0.025)	(0.030)	(0.032)	0.004	0.005
Normalised EPS Growth	(17.2%)	19.1%	6.4%		29.4%
FD Normalised P/E (x)	NA	NA	NA	56.83	43.93
DPS (A$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	29.24	94.36	16.77	14.20
P/FCFE (x)	NA	NA	NA	NA	28.44
Net Gearing	596%	1187%	680%	733%	646%
P/BV (x)	4.08	7.58	4.00	3.81	3.58
ROE	(43.3%)	(77.3%)	(77.9%)	6.9%	8.4%
% Change In Normalised EPS Estimates			(333%)	(54%)	(49%)
Normalised EPS/consensus EPS (x)			2.43	3.61	-4.67

SOURCE: MORGANS, COMPANY REPORTS

Genex Power

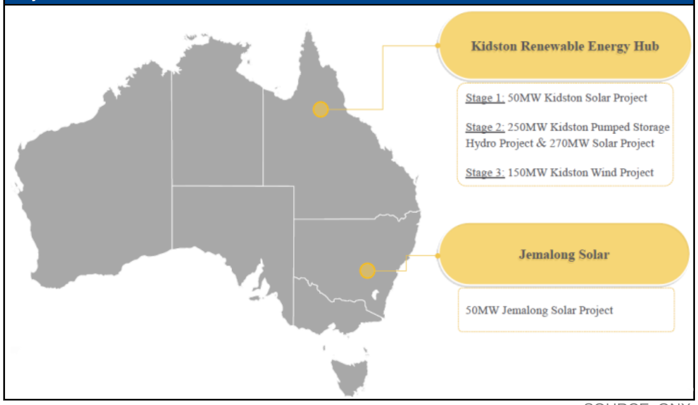
as at February 28, 2020

Market cap (A$m):	82.38	Rating:	SPECULATIVE BUY
Shares outstanding (m):	312.4	Price (A$):	0.21
Free float (%):	69.3	Target price (A$):	0.26
Website:	https://www.genexpower.com.au/	Upside/downside to target price (%):	26.8

Company description

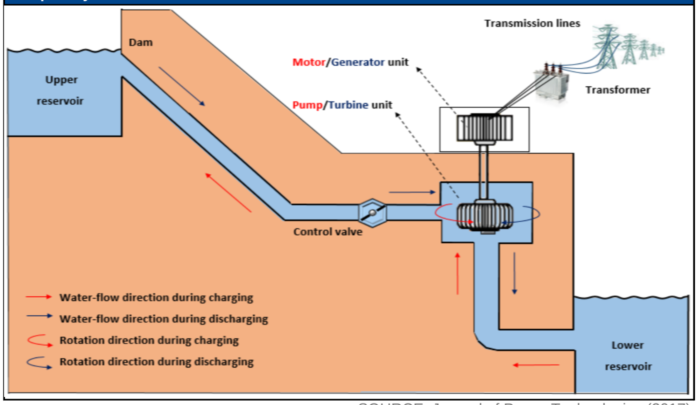
GNX is redeveloping an old gold mine in North Queensland into an energy storage project and has developed a 50MW solar farm adjacent to the mine. GNX also has plans to expand its energy generation with a second stage solar farm up to 270MW and a potential 150MW wind farm, on or near the same site, and a 50MW solar farm in central NSW. The output of the 50MW solar farm is contracted to the Qld government for 20 years and the company is in discussions with Energy Australia to sell the output of the pumped hydro project. GNX has also obtained approval for up to $610m of low cost debt finance from the Northern Australia Infrastructure Facility. GNX was founded in 2011 and was listed on the ASX in 2015. The CEO, James Harding, was appointed on the 7th of May 2018 and the Chairman, Dr Ralph Craven, has held his position since the company listed.

Projects overview



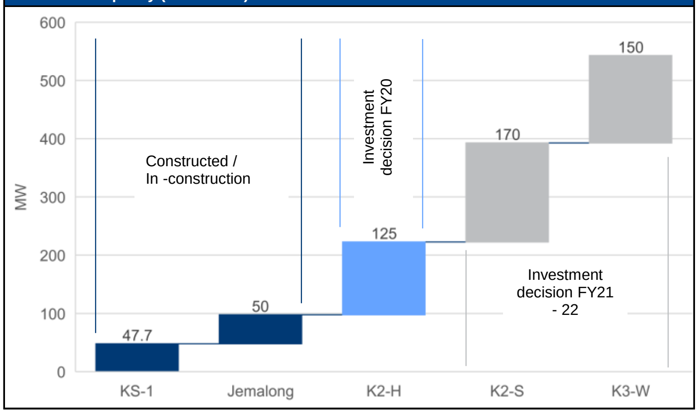
SOURCE: GNX

Pumped Hydro overview



SOURCE: Journal of Power Technologies (2017)

Generation Capacity (GNX share)



SOURCES: MORGANS, GNX

Risks and Drivers

Value drivers:

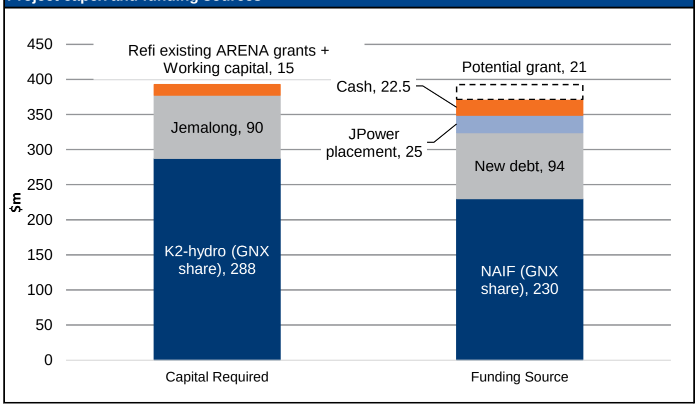
- Solar output of Stage 1 as price is contracted and locked in.
- NSW spot price of electricity as Jemalong will likely be uncontracted.
- Spot price of LGCs as Jemalong will likely be uncontracted.
- If carbon reduction targets increase, the value of future renewables projects will also increase.
- Successful renegotiation of K2-H offtake agreement.

Risks:

- Pumped hydro offtake agreement not yet finalised.
- Price of engineering contract to build K2-H pumped hydro project.
- Cost to access new transmission line for K2-H pumped hydro projet.
- Construction risk of the Jemalong and K2-H pumped hydro projects.
- Access to concessional funding (e.g. ARENA) to fund projects at low costs of capital.
- Electricity network congestion if too many other renewables projects nearby get constructed.
- Marginal Loss Factors (MLF) on all projects other than KS-1.
- Technological changes driving energy efficiency and alternative generation.
- Interest rates.
- Changes to tax regimes.

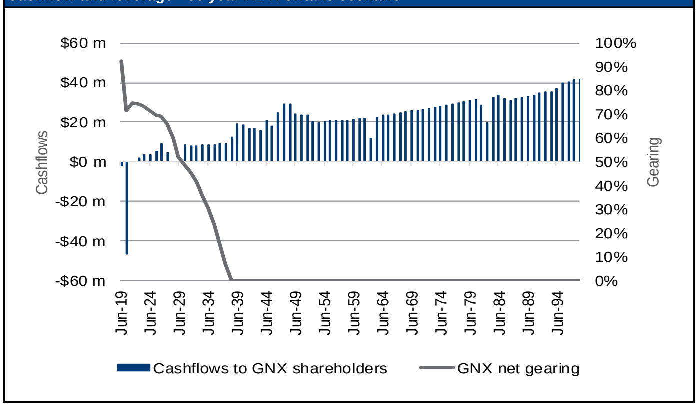
SOURCE: MORGANS

Project capex and funding sources



SOURCES: MORGANS, GNX

Cashflow and leverage - 30 year K2-H offtake scenario



SOURCE: MORGANS

Figure 1: Financial summary (excludes K2-H)

Key multiples & gearing	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
EV/EBITDA (x)	N/A	29.4	98.1	16.6	13.9	14.0	14.0	13.1	12.5	11.8	11.2
Price-to-earnings (x)	N/A	N/A	N/A	N/A	6	7.2	8.4	7.7	7.2	6.7	6.3
Dividend yield (%)	-	-	-	-	-	-	-	-	4.2	4.2	4.3
Net Debt / ND+E (%)	85.6	92.2	86.9	86.6	84.0	81.4	78.8	75.8	74.7	73.3	71.7
Profit and loss ($m)	**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**FY28E**
Net Revenue	8.3	10.8	9.7	20.3	22.6	21.8	21.2	21.5	21.7	22.0	22.3
Other inc	1.7	4.8	1.2	-	-	-	-	-	-	-	-
Expenses	(11.7)	(10.0)	(8.6)	(5.9)	(6.4)	(6.5)	(6.6)	(6.7)	(6.9)	(7.0)	(7.2)
EBITDA	(1.7)	5.6	2.3	14.4	16.3	15.3	14.6	14.7	14.8	14.9	15.1
D&A	(3.0)	(6.4)	(7.8)	(7.1)	(8.6)	(8.6)	(8.6)	(8.6)	(8.6)	(8.6)	(8.6)
Operating EBIT	(4.7)	(0.8)	(5.6)	7.2	7.6	6.7	6.0	6.1	6.2	6.3	6.5
Net Interest Expense	(2.7)	(4.7)	(3.8)	(3.1)	(2.9)	(2.8)	(2.6)	(2.4)	(2.3)	(2.1)	(2.0)
K2H equity accounted profit	-	-	-	-	-	-	-	-	-	-	-
Profit Before Tax	(7.5)	(5.5)	(9.3)	4.2	4.7	3.9	3.3	3.7	3.9	4.2	4.5
Tax	-	-	0.2	(1.1)	(1.3)	(1.1)	(0.9)	(1.0)	(1.1)	(1.2)	(1.2)
Statutory Net Profit	(7.5)	(5.5)	(9.1)	3.0	3.4	2.8	2.4	2.7	2.8	3.0	3.3
Exceptional items (post tax)	-	-	-	-	-	-	-	-	-	-	-
Underlying Net Profit	(7.5)	(5.5)	(9.1)	3.0	3.4	2.8	2.4	2.7	2.8	3.0	3.3
Cashflows ($m)	**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**FY28E**
EBITDA	(1.7)	5.6	2.3	14.4	16.3	15.3	14.6	14.7	14.8	14.9	15.1
K2H SPV distributions	-	-	-	-	-	-	-	-	-	-	-
WC & non-cash adjustments	(0.5)	(0.8)	5.4	(5.5)	0.1	0.0	(0.5)	(0.0)	(0.0)	(0.0)	(0.0)
Gross operating cashflow	(2.2)	4.8	7.7	8.9	16.3	15.4	14.1	14.7	14.8	14.9	15.1
Net interest paid	(3.9)	(4.3)	(3.8)	(3.1)	(2.9)	(2.8)	(2.6)	(2.4)	(2.3)	(2.1)	(2.0)
Cash paid for Tax	-	-	-	(0.9)	(1.3)	(1.1)	(0.9)	(1.0)	(1.1)	(1.2)	(1.2)
Operating cashflow	**(6.1)**	**0.5**	**3.9**	**4.9**	**12.1**	**11.5**	**10.5**	**11.3**	**11.5**	**11.7**	**11.9**
Capex	(83.0)	(12.2)	(63.2)	(21.7)	-	-	-	-	-	-	-
Investing cashflow	**(83.0)**	**(12.2)**	**(63.2)**	**(21.7)**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Equity issuance/(returns)	3.2	1.9	20.5	-	-	-	-	-	-	-	-
Debt drawdown/(repaid)	85.1	2.3	58.9	16.2	(7.2)	(7.4)	(5.8)	(8.0)	(8.3)	(8.6)	(8.9)
Dividends paid	-	-	-	-	-	-	-	-	(3.4)	(3.5)	(3.6)
Financing cashflow	**88.3**	**4.3**	**79.3**	**16.2**	**(7.2)**	**(7.4)**	**(5.8)**	**(8.0)**	**(11.8)**	**(12.1)**	**(12.5)**
Net cashflow	**(0.7)**	**(7.4)**	**20.1**	**(0.6)**	**4.9**	**4.1**	**4.7**	**3.2**	**(0.3)**	**(0.4)**	**(0.6)**
Balance sheet ($m)	**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**	**FY25E**	**FY26E**	**FY27E**	**FY28E**
Cash	11.0	3.5	23.2	22.6	27.5	31.5	36.2	39.5	39.2	38.7	38.1
Receivables	0.9	2.0	0.5	1.0	1.0	0.9	1.8	1.9	1.9	1.9	1.9
Fixed Assets	118.2	118.1	172.9	187.5	178.9	170.3	161.7	153.0	144.4	135.8	127.2
SPV equity	-	-	-	-	-	-	-	-	-	-	-
Tax assets	-	-	0.2	-	-	-	-	-	-	-	-
Other	5.6	11.0	16.2	16.2	16.2	16.2	16.2	16.1	16.1	16.1	16.1
Total Assets	**135.6**	**134.5**	**213.1**	**227.2**	**223.5**	**218.9**	**215.9**	**210.5**	**201.6**	**192.6**	**183.4**
Debt	102.1	103.7	162.5	178.7	171.5	164.1	158.3	150.2	141.9	133.3	124.4
Deferred Tax from SPV)	-	-	-	-	-	-	-	-	-	-	-
Other liabilities	18.3	22.4	29.5	24.4	24.5	24.5	24.8	24.9	24.9	24.9	24.9
Total Liabilities	**120.4**	**126.1**	**192.0**	**203.1**	**196.0**	**188.6**	**183.1**	**175.1**	**166.8**	**158.2**	**149.3**
Net Assets	**15.3**	**8.4**	**21.1**	**24.1**	**27.5**	**30.3**	**32.8**	**35.4**	**34.8**	**34.4**	**34.1**
Ave shares on issue (m)	**303.9**	**312.4**	**401.8**	**401.8**	**401.8**	**401.8**	**401.8**	**401.8**	**401.8**	**401.8**	**401.8**

SOURCE: MORGANS RESEARCH, COMPANY

Result summary and assumption changes

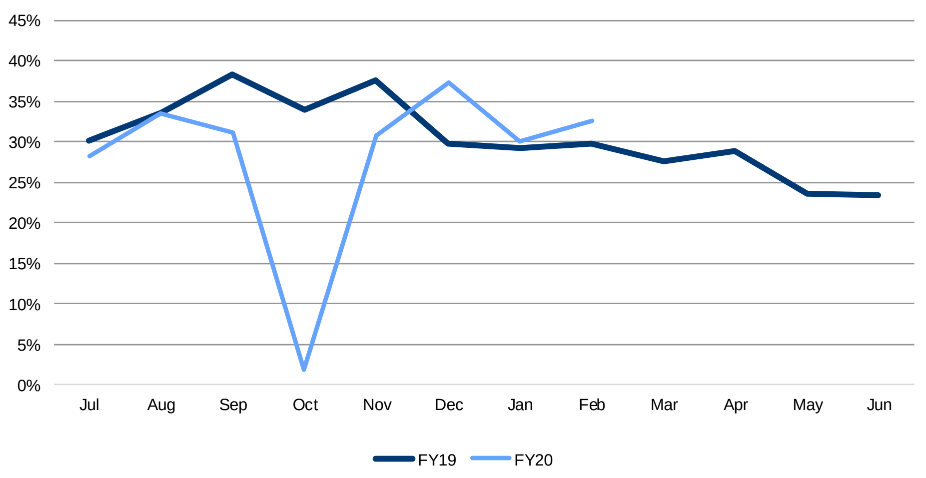
Figure 2: Results summary

(A$m)	1H19A	2H19A	FY19A	1H20A	1H20F	FY20F	f'cast diff % chg	pcp diff % chg
Production(GWh)	71.3	55.5	126.8	56.4	69.0	118.3	-18.3	-20.9
Commodity Sales	6.1	4.7	10.8	4.5	6.0	66.3	-25.3	-27.0
Total Revenue	**8.8**	**6.9**	**15.6**	**4.9**	**8.1**	**10.1**	**-39.1**	**-43.6**
Operating expenses	5.0	5.0	10.0	6.2	2.4	7.9	61.0	24.1
% of revenue	57.1	73.4	64.2	125.7	29.8	77.7	96 bps	69 bps
EBITDA	**3.8**	**1.8**	**5.6**	**(1.3)**	**5.7**	**2.3**	**-122.3**	**-133.7**
EBITDA margin (%)	42.9	26.6	35.8	(25.7)	70.2	22.3	-96 bps	-69 bps
EBIT	0.6	(1.4)	(0.8)	(6.3)	0.4	(5.6)	-106.4	-1130.8
EBIT margin (%)	7.0	(20.3)	(5.0)	(127.2)	4.9	(54.9)	-132 bps	-134 bps
Net profit after tax	**(1.6)**	**(3.8)**	**(5.5)**	**(8.4)**	**(0.0)**	**(8.4)**	**N/A**	**-413.3**
EPS (cps)	(0.5)	(1.3)	(1.8)	(2.1)	(0.0)	(2.1)	N/A	283.2
Total comprehensive income	**(2.6)**	**(6.6)**	**(9.2)**	**(9.7)**	**(0.0)**	**(9.7)**	**N/A**	**-276.2**

SOURCES: MORGANS, COMPANY REPORTS

Output from KS1 dropped in October 2019 due to the inverter not meeting AEMO's technical requirements. GNX is negotiating a claim with its contractors for the impact of the lost production. 3Q production appears to be tracking with expectations while we expect 4Q to weaken in line with seasonal trends.

Figure 3: Kidston Solar Farm capacity factor



SOURCE: MORGANS RESEARCH, COMPANY

Figure 4: Assumption changes

Difference between forecasts (%)	FY21	FY22	FY23
NSW spot electricity	-16%	-14%	-14%
Spot LGC	-9%	-1%	0%

SOURCE: MORGANS

A refresh of K2-H's fundamentals

QLD growth of renewables – what's needed to firm them?

QLD continues to have an ambitious growth target for renewable energy. The Queensland Government has identified a number of projects in North Queensland to help it meet its 50% renewable energy target. North Queensland has both high quality solar and wind resources. AEMO has designated three potential Renewable Energy Zones (REZ) in its plans for the development of the electricity market. Large scale energy storage will significantly improve the economic prospects of these projects and help stabilise the grid.

Figure 5: Planned North Queensland renewable projects and transmission lines

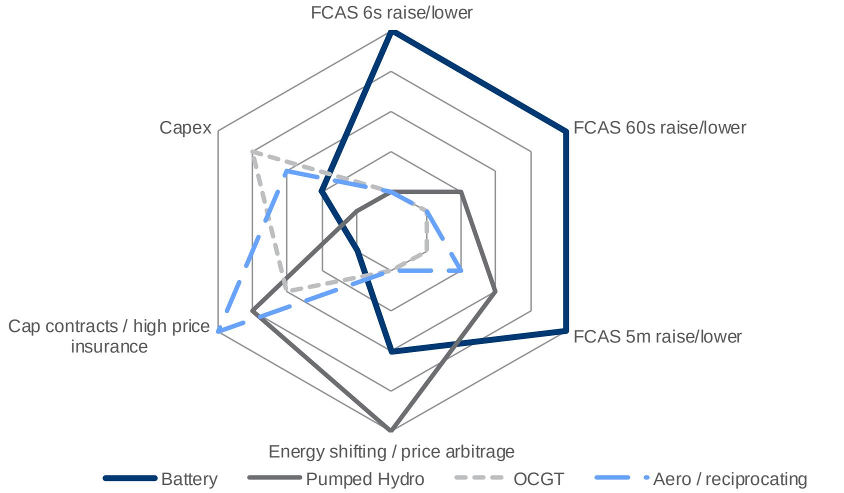
SOURCE: DNRME – POWERING QUEENSLAND PLAN

Price volatility & FCAS – how does pumped hydro take advantage?

Energy storage assets can take advantage of spot price volatility (buying low and selling high) as well as selling services to the grid, known formally as Frequency Control and Ancillary Services (FCAS). The share of revenue from either energy arbitrage or FCAS will depend on the technology used by the project. Typically, batteries will target the FCAS market more than arbitrage as their response times are in fractions of seconds (good for the 6s response time raise/lower FCAS services) while the energy storage time at maximum output is usually less than two hours. Pumped hydro assets on the other hand are more likely to target energy arbitrage and price cap contracts than FCAS.

There is a range of technologies that offer various firming services to the electricity market. FCAS services are important for maintaining the electricity supply within its technical limits by adjusting its frequency. Energy shifting moves energy between periods of high supply to periods of peak demand. Similarly price arbitrage captures the value between the extreme low and high price points. Cap contracts are the usual mechanism for retailers to insure themselves against extremely high prices events. Generation needs to start quickly and be able to run for extended periods to effectively underwrite this kind of service. Historically Open Cycle Gas Turbine (OCGT) plants met this need as they are comparatively cheap when weighing the build cost against the useful life of the asset. The incoming five minute settlements rule change and the faster start times of competing technology will likely see them phased out over time.

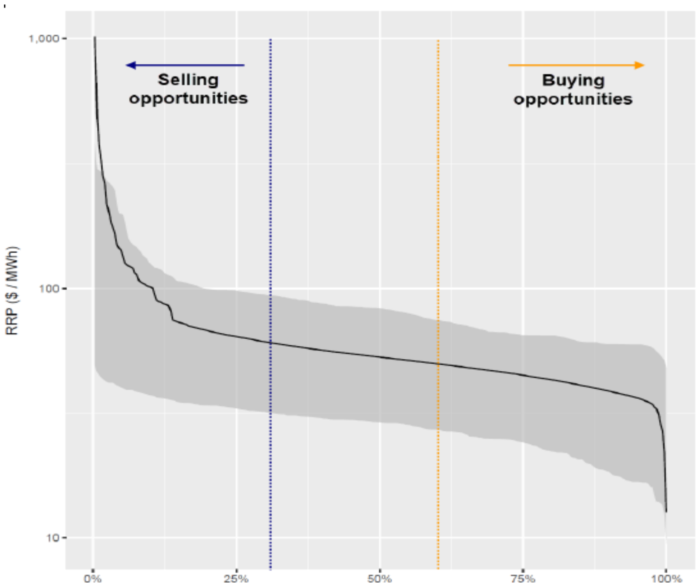
Figure 6: Firming technology comparison



SOURCE: MORGANS

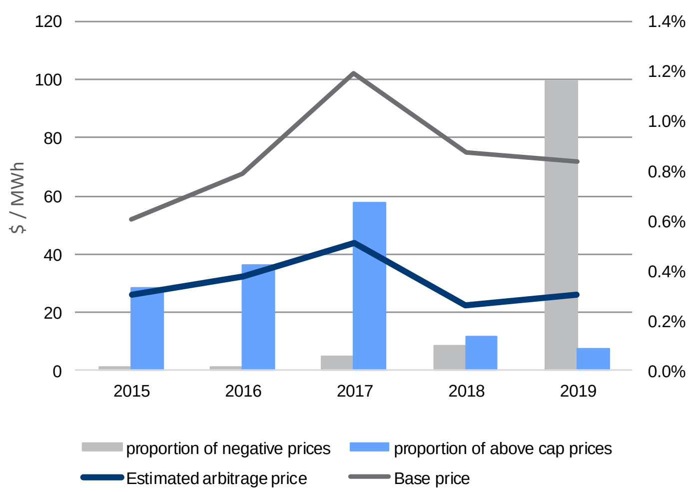
Spot energy prices in the NEM have a wide range of possible outcomes set by regulation. Currently, prices can range from -$1,000/MWh up to $14,700/MWh. While spot prices across the NEM in FY20 have been lower on average, price volatility is still a feature and can present opportunities to arbitrage the spot price. As an electrical load while storing energy, a pumped hydro asset will effectively be paid to pump energy when prices are less than $0 and these instances are becoming increasingly common. Apart from arbitrage, pumped hydro can also compete with gas peaking stations to capture extremely high priced events. Both of these opportunities in the spot energy market are likely to become more prevalent as coal plants close and renewables increase their market share.

Figure 7: Intra-day spot price arbitrage



SOURCE: MORGANS

Figure 8: Value drivers of QLD spot price arbitrage



SOURCE: MORGANS, AEMO

Valuation scenarios

Base case

We have rolled forward our DCF model by half a year. This increases the KS1 & Jemalong value significantly as we're using a free cash flow to equity technique and the recent capital raising now falls out of the model. However, the increased number of shares offsets the increase in estimated value on a per share basis.

We have used a new method to evaluate the value of the option to develop K2-H. As we don't have detailed information yet on the potential contractual arrangements we've used a very simple DCF and risked the output to value K2-H at $23.3m. Once we have more information on the likely commercial arrangements we will produce a more detailed DCF that would take into consideration any constraints on paying cash to shareholders. We have used the following assumptions in our simplified DCF:

- $21.5m p.a. is GNX's share of EBITDA (indexed with inflation).
- 3% after tax WACC based on Rd of 2.5%, Re of 8% and gearing of 80%.
- $300m GNX share of capex.
- 85% risking factor.

Our other key assumptions in our base case valuation are:

- Jemalong is commissioned during 2Q FY21.
- **Net debt** of **$154m** on completion of **Jemalong**.
- Asset multiple value discounted half a year to FY20.
- **Base case value** is the average of the DCF SOTP (20cps) and the asset multiple based method (31cps), or **26cps**.

Figure 9: GNX DCF base case sum of the parts valuation

Component	Value ($m)	Value (cps)
KS1 & Jemalong	48.7	12
Corporate	-19.8	(5)
GNX K2-H option val	30.8	8
K2-S & K3-W	20.5	5
Total	**80.1**	**20**

SOURCE: MORGANS

Figure 10: Base case asset multiple valuation

Asset	MW	Multiple ($ / W)	EV ($m)	Net Debt ($m)	Equity ($m)
Jemalong + KS1	97.7	2.4	234.5	(155.6)	78.8
K2-H	250	0.1	30.8	-	30.8
K2-S + K3-W	320	0.1	19.7	-	19.7
Total	**667.7**	**0.4**	**284.9**	**(155.6)**	**129.3**
Number of shares					**401.8**
Discounted equity value (cps)					**31**

SOURCE: MORGANS

Bull case

We are maintaining our key assumptions in our bull case valuation:

- **K2-H** valued using a 25% risking factor for DCF SOTP.
- **GNX is acquired** by an infrastructure investor **in four years'** time after the completion of all projects on an asset multiple.
- Assets acquired at the top quartile multiple of comparable transactions (see previous note on 29 May 2019 for list of transactions) and acquisition is discounted back to FY20 at 8% pa.
- **Bull case value** is the average of the DCF SOTP (41cps) and the asset multiple valuation (60cps), or **51cps**.

Figure 11: GNX DCF bull case sum of the parts valuation

Component	Value ($m)	Value (cps)
KS1 & Jemalong	48.7	12
Corporate	-19.8	(5)
GNX K2-H option val	116.0	29
K2-S & K3-W	20.5	5
Total	**165.3**	**41**

SOURCE: MORGANS

Figure 12: Bull case asset multiple valuation

Asset	MW	Multiple ($ / W)	EV ($m)	Net Debt ($m)	Equity ($m)
Jemalong + KS1	97.7	3.1	302.9	(153.9)	149.0
K2-H	125	2.1	262.5	(230.0)	32.5
K2-S + K3-W	320	3.1	992.0	(440.0)	552.0
Total	**542.7**	**2.9**	**1,557.4**	**(823.9)**	**733.5**
Estimated future number of shares (m)					**1015.4**
Discounted equity value (cps)					**60**

SOURCE: MORGANS

Bear case

We are maintaining our key assumptions in our bear case valuation:

- **Corporate** costs of **5cps** have been **excluded**.
- The **DCF of the assets** excluding corporate overheads represent the **value to an acquirer**.
- **Bear case value** only includes the KS1 and JSP assets (**12cps**).

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