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Power

Renewables and regulation short circuit prices

January 4, 2023

- Wholesale electricity prices continue to tumble as growing renewables' market share and government intervention weigh on both spot and futures markets.
- We expect a jump in tariffs in FY24 when the draft DMO is released in February but we're less confident of continued increases into FY25.
- Our view is that upside is limited in the sector but for those willing to accept higher risks, there is potentially significant upside for GNX.

Summer spot prices well below the squeeze anticipated by the futures market

- NSW and QLD average prices settled at ~$120/MWh in the last quarter. This is well below the >$200/MWh level that the baseload futures contracts were trading at when the quarter began. Futures prices have tumbled across the board with prices expected to remain at more normal levels during CY23 and beyond.
- So far, summer temperatures have been mild while renewables output and capacity have climbed. This has meant that wind and solar have claimed more market share from fossil fuels, and black coal in particular.
- Government intervention to limit the costs of fuel are also likely having an effect on the outlook. In the longer term though we fear this may lead to underinvestment in generation and upstream fuel projects.

Retail rebound may not last beyond FY24

- The integrated retailers are likely to receive an earnings boost as we think that the past six months of extreme prices will have an effect on tariffs next year. Outside a further period of energy market volatility, tariffs are likely to soften in FY25, limiting the upside for AGL and ORG.
- We downgrade our rating on AGL to HOLD because of the softening outlook. We retain our HOLD rating on ORG because of the possibility of the takeover proceeding but we see downside risks because of the proposed code of conduct.

Juniors have to make do with weakening merchant outlook

- The outlook for smaller, more spot exposed generators like GNX and LGI will also be softer and in the long term, they are both price takers.
- LGI has better short term price protection and much lower risk but we believe it is appropriately valued and maintain our HOLD rating.
- GNX faces significant construction risk and as a result we think the market is under-pricing the stock. We upgrade to SPECULATIVE BUY but we note there are significant risks to be overcome for our 27cps price target to be realised.

Highlighted companies

AGL Energy (downgrade to HOLD)

Given the softer outlook in the electricity market and steady share price gains we downgrade our rating to HOLD. Softer forecast earnings have reduced our target price 11% to $7.88. We see AGL as the most well positioned company because of its vertical integration and long term fuel contracts. Higher investment uncertainty in the sector makes it harder to identify upside.

Genex Power (upgrade to SPECULATIVE BUY)

GNX's suitors have abandoned their pursuit of the company and the share price has fallen. We think the market is effectively writing off any value associated with Kidston Hydro. We upgrade our rating to SPECULATIVE BUY and revert to our blended DCF and EV/MW valuation for an updated price target of 27cps. Risks are stacking up for the company however and it will not suit all investors.

Max Vickerson

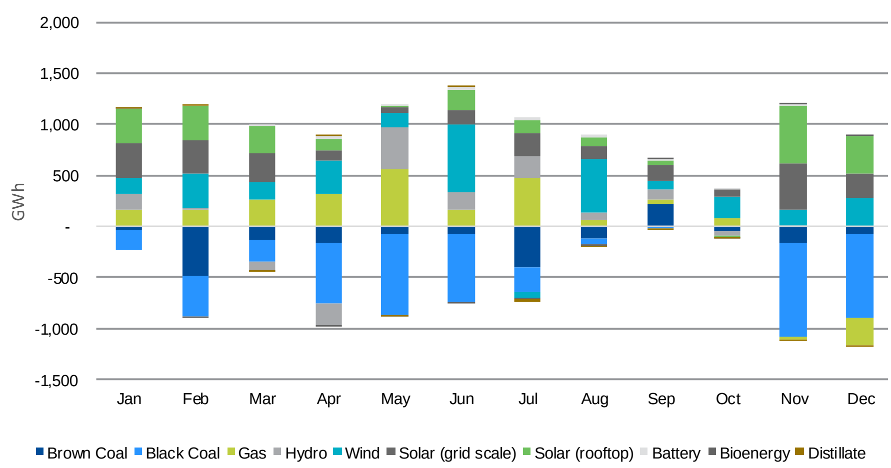
+61 7 3334 4804

max.vickerson@morgans.com.au

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

– Genex Power

Figure 1: CY22 NEM generation output changes vs pcp



Source: Morgans Financial, Open NEM

Figure 2: NSW baseload electricity futures monthly average price history (legend shows trading month)

Source: Morgans estimates, company data

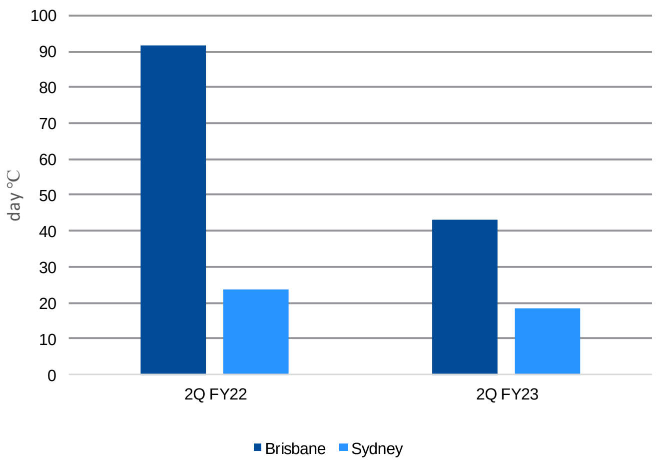
Electricity and carbon markets

Coal losing more ground to renewables

A combination of mild summer temperatures and stronger competition from renewables led to black coal volumes and electricity falling significantly in the last quarter. Cooling needs in the two key metro areas in northern states, i.e. Brisbane and Sydney was markedly reduced. This has led to continued significantly fewer price spikes, and therefore average prices, in QLD during evening peak demand periods.

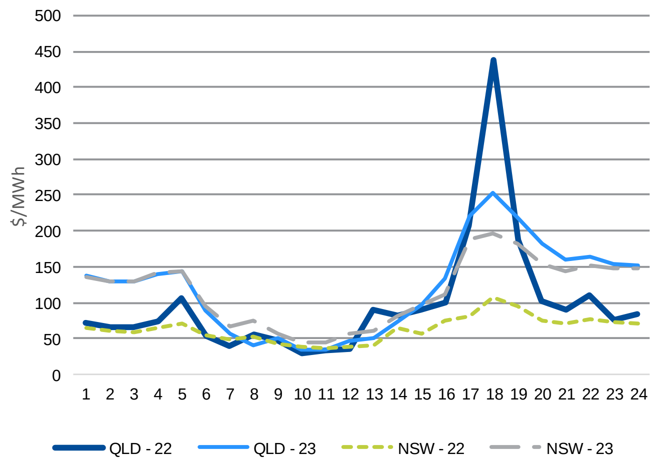
Solar (rooftop and grid-scale) output has jumped which has kept spot prices suppressed during daylight hours. NSW prices have been stronger in evening and overnight periods, most likely as a result of higher fuel prices but this could change with government intervention.

Figure 3: Cooling degree days comparison (24C Base)



Source: Morgans estimates, Wolfram Alpha

Figure 4: Average hourly 2Q prices

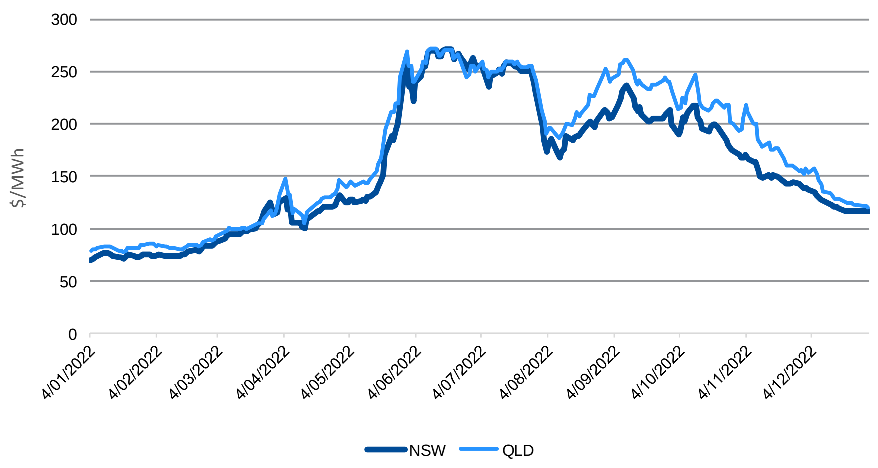


Source: Morgans estimates, AEMO

Futures curve falling away softens medium term tariff outlook

Given the softer spot market conditions and the prospect of intervention weighing on future periods, futures prices have fallen away after jumping to record highs during the winter price squeeze. Just six months ago, electricity traders priced in expected average wholesale prices of over $250/MWh in NSW and QLD. Instead, the quarter just settled at ~$120/MWh. This has impacted on the outlook for futures years as well. For example, the expectations for CY23 NSW baseload fell from ~$240/MWh in October down to a traded average of ~$155/MWh during December.

Figure 5: December quarter baseload futures price history

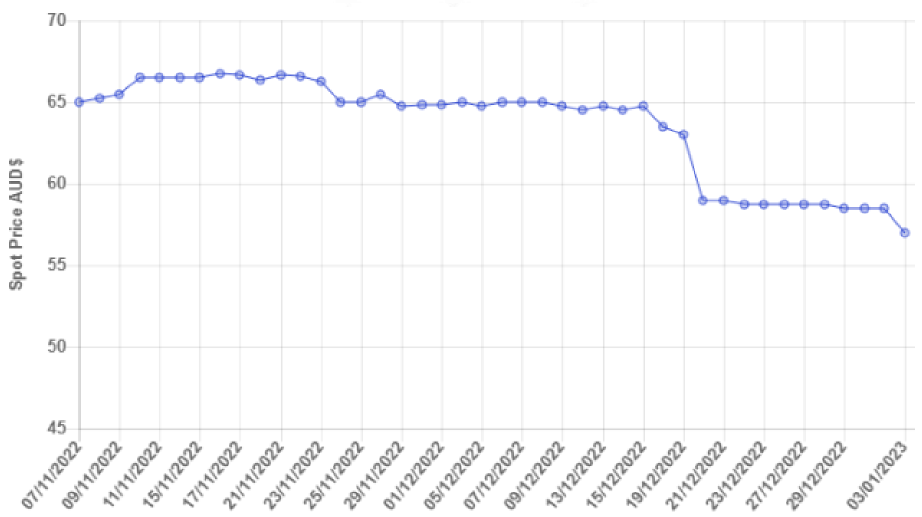


Source: Morgans estimates, Bloomberg

Carbon prices are mixed

Spot prices for Large-scale Generation Certificates (LGCs) have softened while Australian Carbon Credit Units (ACCUs) continue to be range bound between $25/CO2-e to $35/CO2-e. LGC futures remain in backwardation out to CY26.

Figure 6: LGC spot price history



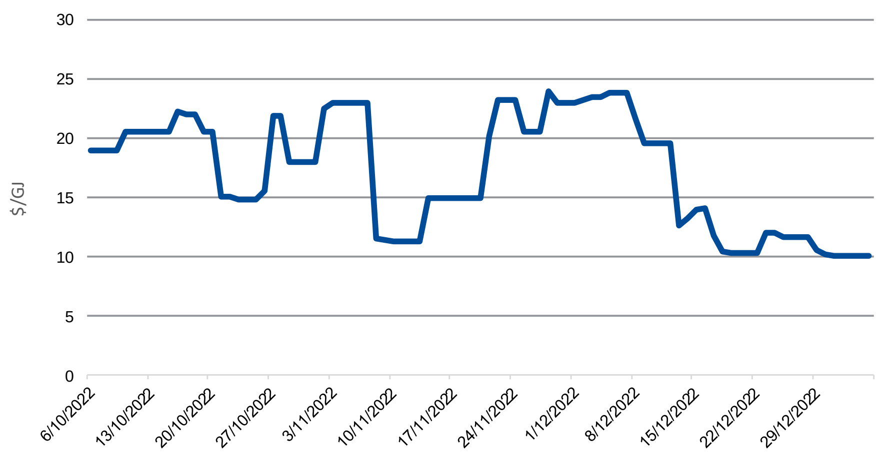
Source: Morgans estimates, company data

Gas markets

Spot prices fall below price cap

Spot prices for gas have fallen below the $12/GJ price cap although there are reports of a disconnect developing between tariffs and wholesale prices. We doubt that retailers would seriously entertain making themselves a target for the ACCC and we would expect that new tariffs will be based on available wholesale domestic supply costs.

Figure 7: Wallumbilla benchmark price

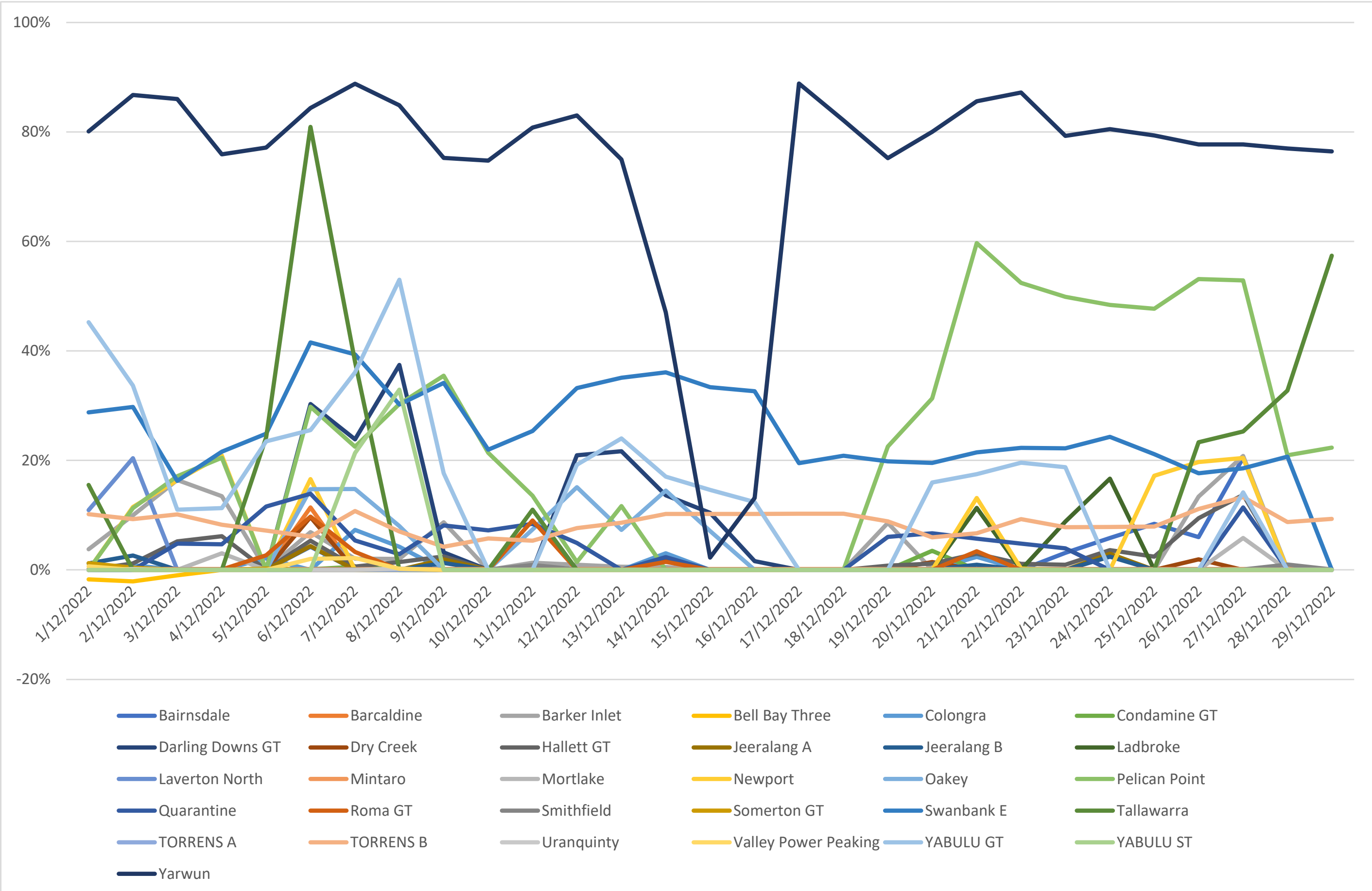


Source: Morgans estimates, AEMO

Gas fired generation also drops

Despite spot gas prices falling we haven't seen an appreciable difference in the utilisation of gas fired generation during December. This is likely due to the fact that so far, spot electricity prices have been subdued.

Figure 8: December 2022 gas plant capacity factors



Source: Morgans estimates, AEMO

What does this mean for the sector?

Large integrated retailers

Australia's two listed large scale integrated retailers, AGL and ORG, will not be able to count on a sustained recovery in margins beyond FY24. Default retail electricity tariff benchmarks typically average contract prices over a two year period. Because of the large jump in the futures curve during 4QFY22 – 1QFY23, it's likely that tariffs will still increase markedly next year. If the government intervention to lower fuel costs is successful at averting future market shocks, then the rally will likely be short lived.

For the rest of the decade, we think that the intervention will only add to investment uncertainty for both new generation and fuel supply. New policies are being proposed to incentivise non-fossil fuel storage and firming capacity but we still see an increasing likelihood of supply constraints as coal plants retire. Companies with a greater degree of integration and long term fuel supply will be less vulnerable to market shocks, all things being equal.

Spot exposed generators

Smaller generators such as GNX and LGI have somewhat less room to manoeuvre. Both companies have some protection (LGI more than GNX) in the short term but in the long term both are essentially price takers. Prices are still above historical averages but neither company can expect a return to recent record highs.

Genex Power

Back to plan A

Skip and Stonepeak are no longer pursuing their acquisition of GNX and Stonepeak is no longer a substantial holder of the company's stock. The share price has fallen significantly, effectively ignoring the value of the hydro project given our estimate for the solar farms, Bouldercombe and K3-W. We upgrade our rating to SPECULATIVE BUY and price target to 27cps (+35%, +107% upside to today's closing price) on the view that GNX can successfully deliver its growth projects.

We do note though that the risks to this occurring have increased. The cost increases flowing from the Main Access Tunnel (MAT) workarounds indicate that GNX hasn't successfully transferred all of its risk to its contractors and there is still another 18 months of significant construction activity to complete. As the market saw with the collapse of Clough, fixed price contracts are also vulnerable to the financial health of contractors. We don't see any glaring issues in the limited information available publicly but it is a risk we can't rule out entirely.

Changes to forecasts

We lower our forecasts for earnings mostly as a result of weaker electricity pricing and to a lesser extent, carbon as well. We also anticipate slightly lower solar volumes this year.

Figure 13: Forecast changes

Absolute changes	FY23	FY24	FY25	Relative changes (%)	FY23	FY24	FY25
Production (GWh)	(2.5)	-	-	Production	-1%	0%	0%
Revenue ($m)	(7.3)	(3.2)	(2.4)	Revenue	-20%	-8%	-4%
EBITDA ($m)	(7.3)	(3.2)	(2.4)	EBITDA	-34%	-13%	-3%
D&A ($m)	-	-	-	D&A	0%	0%	0%
Net interest expense ($m)	(0.0)	(0.0)	(0.0)	Net interest expense	0%	0%	0%
Net Profit After Tax ($m)	(7.3)	(2.9)	(1.8)	Net Profit After Tax	-183%	-43%	-9%
Capital Expenditure ($m)	-	-	-	Capital Expenditure	0%	0%	0%
Debt ($m)	-	-	-	Debt	0%	0%	0%
Cash balance ($m)	(7.1)	(10.3)	(11.4)	Cash balance	-18%	-38%	-31%

Source: Morgans estimates

Risks:

- Successful completion of K2H project on time and with no further cost increases.
- Successful completion of the Bouldercombe battery project and the K3W windfarm.
- Solar production at Kidston Solar and Jemalong.
- Marginal loss factors on all projects other than K2H and KS-1.
- Electricity and carbon prices.
- Interest rates, increases in inflation (K2H has mostly fixed escalators), energy market regulation and tax regimes.
- Refinancing of existing debt when it matures.

Figure 14: GNX Financial Summary

Production & Price	FY21A	FY22A	FY23E	FY24E	FY25E
Solar generation (GWh)	150.2	224.1	224.9	247.6	245.7
Wind generation (GWh)	-	-	-	-	-
Hydro capacity (MW)	-	-	-	-	125
Battery capacity (MW)	-	-	-	50	50
Ave generation price ($/MWh)	87.4	115.3	129.1	103.6	99.1
Ave storage price ($/MWh)	-	-	-	26.1	24.0

Valuation	DCF ($m)	EV x ($m/MW)	EV ($m)	Net debt ($m)	Equity ($m)	Blended ($m)	Blended (cps)
Solar	27.8	2.40	234.5	(168.6)	65.9	46.8	3.4
Hydro	194.7	3.30	825.0	(648.0)	177.0	185.8	13.4
Battery	82.4	1.20	60.0	(11.3)	48.7	65.6	4.7
Wind	94.0	0.38	57.0	-	57.0	75.5	5.5
Total	**398.9**		**1,176.5**	**(827.9)**	**348.5**	**373.7**	**27.0**
Price target (cps)							**27.0**

Profit and loss ($m)	FY21A	FY22A	FY23E	FY24E	FY25E
Net Revenue	10.6	24.8	29.0	36.3	60.2
Other inc	11.0	2.4	0.4	0.8	20.8
Expenses	(28.5)	(13.4)	(15.4)	(16.3)	(11.7)
EBITDA	(6.8)	13.8	14.0	20.8	69.2
D&A	(6.3)	(10.1)	(10.9)	(13.9)	(22.3)
Operating EBIT	(13.1)	3.7	3.1	6.9	46.9
Net Interest Expense	(5.7)	(7.7)	(14.4)	(18.8)	(20.4)
Profit Before Tax	(18.7)	(4.1)	(11.3)	(11.9)	26.5
Tax	-	-	-	2.3	(7.8)
Net Profit	(18.7)	(4.1)	(11.3)	(9.6)	18.7
EPS (cps)	(3.1)	(0.3)	(0.8)	(0.7)	1.2
DPS (cps)	-	-	-	-	-

Key Multiples	FY21A	FY22A	FY23E	FY24E	FY25E
EV/EBITDA (x)		64.5	63.7	42.8	12.9
Price-to-earnings (x)					11.5
Dividend yield (%)	-	-	-	-	-
Free cashflow yield (%)	-85%	-121%	-188%	-59%	-127%
Net Debt / ND+E (%)	52%	62%	78%	81%	71%
Net Debt / EBITDA (x)	(21.2)	23.3	48.1	37.6	12.9
Operating CF-to-interest (x)	(0.9)	0.7	0.1	2.7	2.2

Balance Sheet	FY21A	FY22A	FY23E	FY24E	FY25E
Cash	45.4	62.9	31.3	17.1	25.3
Receivables	1.2	3.3	1.2	1.1	1.0
Inventory & prepayments	2.7	3.4	3.4	3.4	3.4
Other	-	-	-	-	-
Current Assets	**49.4**	**69.5**	**35.8**	**21.6**	**29.8**
Bank guarantees	5.0	71.9	71.9	21.9	21.9
PPE	291.9	447.7	789.5	827.7	1,091.6
Other	13.4	28.0	28.0	140.4	172.0
Non-Current Assets	**310.3**	**547.6**	**889.5**	**990.1**	**1,285.5**
Total Assets	**359.7**	**617.2**	**925.3**	**1,011.6**	**1,315.3**
Payables	11.8	13.6	13.6	13.7	13.3
Debt	7.7	18.9	10.8	9.3	26.1
Other	2.9	4.6	4.6	4.6	4.6
Current Liabilities	**22.4**	**37.2**	**29.1**	**27.5**	**44.0**
Debt	181.9	366.6	694.1	791.6	889.1
Government grant	6.9	6.4	6.4	6.4	6.4
Provisions	3.8	3.8	3.8	3.8	3.8
Other	10.4	2.9	2.9	2.9	2.9
Non-current Liabilities	**203.0**	**379.7**	**707.2**	**804.7**	**902.2**
Total Liabilities	**225.4**	**416.9**	**736.3**	**832.2**	**946.2**
Share capital	195.8	242.1	242.1	242.1	376.9
Reserves	(2.0)	21.8	21.8	21.8	61.8
Accumulated earnings	(59.5)	(63.6)	(74.9)	(84.5)	(69.6)
Equity	**134.3**	**200.3**	**189.0**	**179.4**	**369.1**
WANOS (m)	**607.9**	**1,173.2**	**1,385.2**	**1,385.2**	**1,586.6**

Cashflows ($m)	FY21A	FY22A	FY23E	FY24E	FY25E
EBITDA	(6.8)	13.8	14.0	20.8	69.2
WC & non-cash adjustments	7.5	(4.3)	2.2	50.1	(0.4)
Gross operating cashflow	0.7	9.6	16.2	70.9	68.9
Net interest paid	(5.6)	(5.6)	(14.4)	(18.8)	(20.4)
Cash paid for Tax	-	-	-	(0.9)	(3.1)
Operating cashflow	**(4.8)**	**4.0**	**1.8**	**51.2**	**45.3**
Solar - growth capital	(54.0)	-	-	-	-
Hydro - growth capital	(99.1)	(153.2)	(303.9)	(161.3)	(15.5)
Battery - growth capital	-	(11.2)	(48.8)	-	-
Wind - growth capital	-	-	-	-	(267.0)
Sustaining capital & other	(0.3)	(66.0)	-	-	-
Investing cashflow	**(153.4)**	**(230.4)**	**(352.7)**	**(161.3)**	**(282.5)**
Equity issuance/(buy-backs)	133.2	45.8	-	-	133.0
Debt drawdown/(repaid)	5.0	198.0	319.4	95.9	114.4
Dividends paid	-	-	-	-	(1.9)
Financing cashflow	**138.2**	**243.8**	**319.4**	**95.9**	**245.4**
Net cashflow	**(20.0)**	**17.4**	**(31.6)**	**(14.2)**	**8.2**

Source: Morgans estimates, company data

Queensland

Brisbane	+61 7 3334 4888
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Analyst owns shares in the following mentioned company(ies): Genex Power

Morgans Corporate Limited was Joint Lead Manager to the Placement and Share Purchase Plan of shares in Genex Limited announced to market on 23 February 2022 and received fees in this regard.; Morgans Corporate Limited was Joint Lead Manager and Underwriter to the Initial Public Offer of shares in LGI Limited and received fees in this regard.

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