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## Genex Power

### COMPANY SNAPSHOT

Reuters/Bloomberg:	GNX.AX / GNX AU
Market cap:	US\$25.7m
	A\$34.2m
Current price:	A\$0.19
Average daily turnover:	US\$0.04m
	A\$0.05m
Current shares o/s	180.3m
Free float:	67.0%

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### Solar project taking shape

- The award of grant funding by ARENA was an important step forward by Genex Power (GNX) in the development of its Kidston solar project.
- With the backing of a long-term Queensland Government revenue contract, our stand-alone modelling of the solar project generates an equity IRR of around 24% pa.
- Solar project equity funding requirements may be modest if a project equity stake is sold to a third-party investor.
- GNX is targeting financial close on the solar project in November 2016, with first operations in Q4 2017.
- Completion of the feasibility study for its pumped storage project is imminent. First production from this project is targeted for 2019.

### Award of ARENA grant money triggers Qld Government PPA

GNX has been awarded \$8.85m in grant funding from the Federal Government's ARENA large-scale solar program for its 50MW Kidston solar project. Importantly, the award of the grant triggered award of a fixed-price 20-year power purchase agreement from the Queensland Government under its Solar 150 program (includes both electricity and Large Scale Generation Certificates (LGC) produced by the solar project). The contract is structured as a one-way contract for differences. While the contract price was not disclosed by GNX, the Queensland Government has indicated that prices of \$80-100/MWh were acceptable. The mid-point of this price range would result in the project generating close to \$13m pa of revenue.

### Government PPA provides certainty for debt and equity investors

Given the solar project has secured a long-term government-backed revenue stream, we expect a high proportion of the construction costs may be funded by project finance debt (we assume >\$100m). This gearing, combined with the ARENA grant, should minimise equity funding requirements. Our project modelling assumes only \$10m of an estimated \$126m construction cost (cost sourced from ARENA) will be funded by equity. If GNX sells down an equity interest in the project, there may be no need for a capital raising by GNX to fund the equity requirement (albeit GNX's share of the project will be diluted). GNX is in discussions with potential investors in the project.

### Preliminary forecasts and return estimates for the solar project

First generation and therefore cash flow from the project is relatively quick, given the construction phase is about nine months and GNX can utilise the existing transmission line to sell into the grid. Our project modelling generates an annual EBITDA of \$11-12m in the early years of operation and assumed debt service of about \$9m pa, leaving ~\$2-3m per year for equity distributions. We estimate a base case equity IRR for the project of 24% pa and an Equity NPV using a 7% pa and 9% pa discount rate of \$31m and \$22m, respectively. Key return and valuation factors are construction costs, capacity factor, gearing, and tax structuring. Revenues post-Queensland Government PPA are also important. We discuss our project modelling analysis in detail in this note.

### Pumped storage project continues to be progressed

GNX continues to progress its far larger pumped storage hydro project which GNX says is on track for completion of the feasibility study in the next few weeks. The pumped storage project is a larger (more than three times the capital cost) and more complex project than the solar project. The project will require a new transmission line to be constructed to connect it to the grid. First generation is targeted in 2019. Unless GNX enters into contracts for the purchase and sale of electricity for its pumped storage project, we expect the earnings from the project to be far more volatile than the solar project and reduce the potential debt that could be raised to fund the project's construction.

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## Analysis of the Kidston solar project

- **Project overview:** GNX is developing a large-scale solar photovoltaics project at its Kidston site in north Queensland. The project will be constructed on the tailings storage facility of the former Kidston gold mine. The first stage of the 150MW project comprises a 50MW single axis tracking system, sized to utilise the existing electricity grid connection.
- **Returns analysis:** The internal rate of return of our base case equity cashflow forecast with key assumptions discussed below is ~24% pa. The NPV of the forecast equity cashflow stream is:
  - \$31m using a 7% pa discount rate
  - \$22m using a 9% pa discount rate
  - \$15m using an 11% pa discount rate

The key sensitivities to the IRR/NPV are capital costs, capacity factor, tax structure, and post-PPA spot prices.

- **Generation:** GNX believes the site has the highest solar resource in Australia connected to the National Electricity Market (NEM). The capacity factor of the project is expected to be at least 33%. The charts below show the solar radiation across Australia and the expected generation profile from the project across an average day, by season. We assume 0.35% degradation in generation per year. The sensitivity of returns and valuation to the capacity factor is significant – a capacity factor 10% below our assumption reduces our equity IRR estimate by over 9% pa and our NPV estimates by 40-60% (range due to 7% pa and 9% pa discount rate), and vice versa.

Figure 1: Annual average solar radiation across Australia

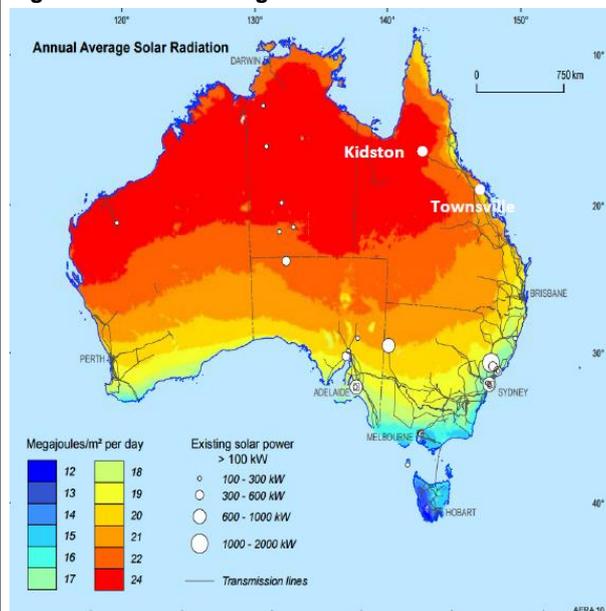
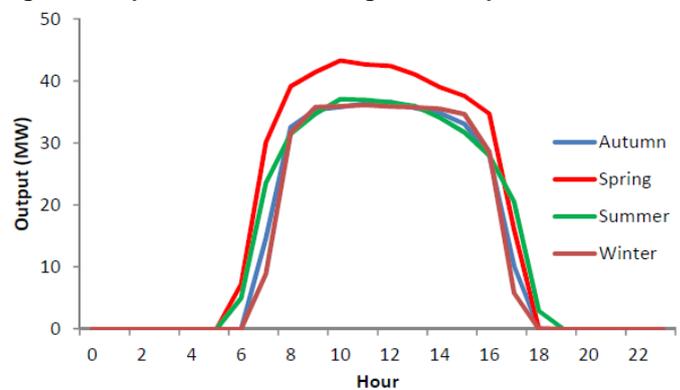


Figure 2: Expected Kidston solar generation profile



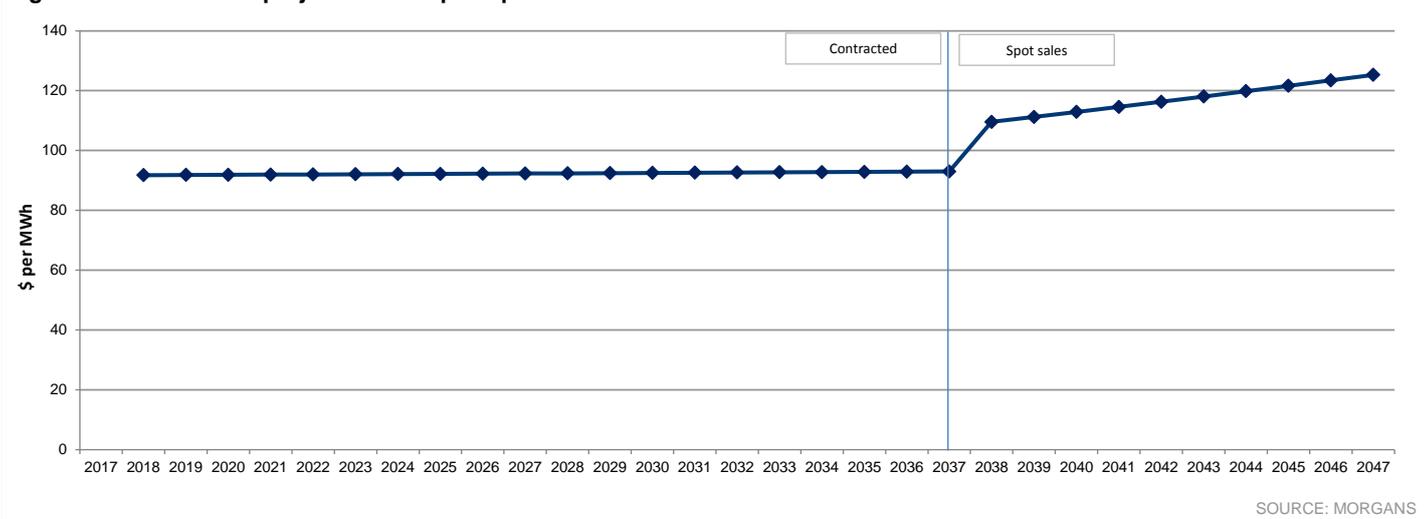
- **Construction:** Construction costs are a key driver of project returns. GNX has not disclosed its expected construction cost. However, ARENA indicated a total project cost of \$126m for the Kidston solar project, implying ~\$2.5m per MW of installed capacity. We note this project cost estimate is higher than the average cost of most other solar plants selected by ARENA for grant funding, such that construction costs may be less than this amount. GNX has indicated that construction is expected to be completed in 2017, following financial close in Q4 2016. UGL has been selected by GNX as the preferred construction contractor (and operations

and maintenance contractor). Construction costs +/-5% different to our assumption cause a -8%/+36% pa change in the equity IRR and impacts our NPV estimates by +/- 18-38% (range due to 7% pa and 9% pa discount rate).

- Grid connection:** The project will connect to the Queensland region of the NEM via an existing substation on-site which, in turn, is connected to the main grid via an existing 132kV transmission line, both of which are owned by Ergon Energy. A connection agreement has been executed with Ergon, which gives GNX access to the transmission line (and thus the National Electricity Market) for 25 years. We assume the distribution loss factor on the Ergon line is 1.0x and the marginal loss factor for the NEM connection point is ~1.07x. Loss factors are updated annually by the Australian Energy Market Operator, thus this is a risk in our modelling.
- Power sales:** During the first 20 years of plant operation, the Kidston solar project will be supported by a 20-year contract with the Queensland Government under its Solar 150 program. The contract is structured as a one-way contract for differences, whereby Kidston revenues will be topped up to the contract price when NEM prices average less than the contract price. When NEM prices exceed the contract price GNX gets to keep all of the revenue. While the contract price was not disclosed by GNX, the Qld Government had indicated that tender prices of \$80-100/MWh (flat nominal) were acceptable to it<sup>1</sup>. Our modelling assumes a contract price at the mid-point of the target range, thus ~\$12.8m of first year revenues supported by the Government contract. We assume a small amount of revenue from price will exceed the contract price (~\$0.5m pa).

Once the contract with the Queensland Government has expired, we assume GNX will operate on a merchant generation basis (ie. uncontracted or spot sales) for the remainder of its life. We acknowledge that accurately forecasting the dispatch-weighted average price for Kidston's generation in 20 years' time is nigh on impossible. We assume \$97/MWh in 2037 (based on an extrapolation of current price dynamics), growing at 75% of CPI thereafter. This is close to the prices implied in the forward contract curve, adjusted for GNX's likely dispatch profile. A \$20/MWh reduction in this 2037 power price assumption reduces our equity IRR estimate by 20 bps and reduces our equity NPV estimate by 10-12% (7-9% pa discount rate).

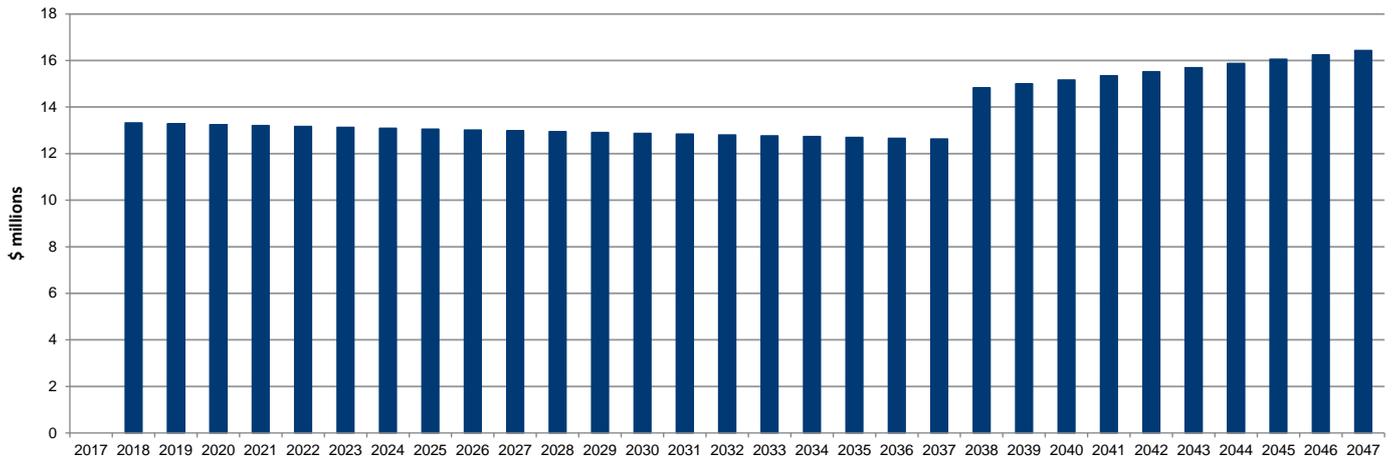
Figure 3: Kidston solar project forecast price per sent-out MWh



SOURCE: MORGANS

<sup>1</sup> See [https://www.dews.qld.gov.au/data/assets/pdf\\_file/0020/307154/solar60-indicative-pricing-range.pdf](https://www.dews.qld.gov.au/data/assets/pdf_file/0020/307154/solar60-indicative-pricing-range.pdf)

**Figure 4: Kidston solar project electricity sales revenue**



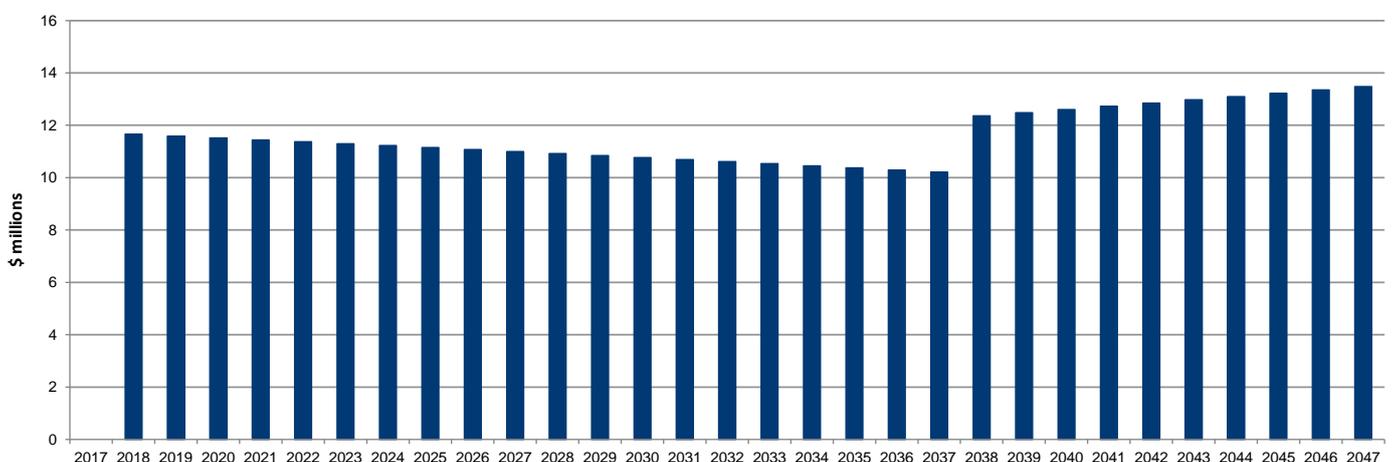
SOURCE: MORGANS

There is a secondary benefit to the merchant generation in 2037. Under the Queensland Government contract volume is based on sent-out generation. In merchant operation, the power station will get the benefit of the transmission marginal loss factor, thereby adding ~7% to forecast revenues.

- **Large Scale Generation Certificates (LGCs):** The current version of the Renewable Energy Target (RET) is due to expire in 2030. During the 20-year contract with the Queensland Government, GNX is obliged to surrender its LGCs to the Government. We assume no LGC revenue at the end of the Queensland Government PPA, given the contract expiry date is beyond the RET expiry date.
- **Costs and EBITDA:** GNX advises that ongoing costs of the project are expected to be relatively small. We assume \$1.5-2.0m pa of costs and sustaining capex, growing with inflation. This results in initial annual EBITDA of ~\$11-12m, declining across the contract period given the flat contract pricing and escalating costs.

GNX believes at the end of the initial O&M contract that it will be able to internalise costs resulting in cost savings. The experience of wind farm operator Infigen Energy has been that costs increased as its wind farms rolled off their initial O&M contracts. Our modelling assumes ongoing inflation-linked growth in costs.

**Figure 5: Kidston solar project EBITDA forecast**



SOURCE: MORGANS

- Tax:** We have assumed a typical company structure for modelling tax. We assume capital costs can be depreciated for tax purposes based on 20-year diminishing value. We forecast tax losses to occur in the early years of the project life, which are then used to offset taxable income until fully utilised. Material tax payments commence in 2029.

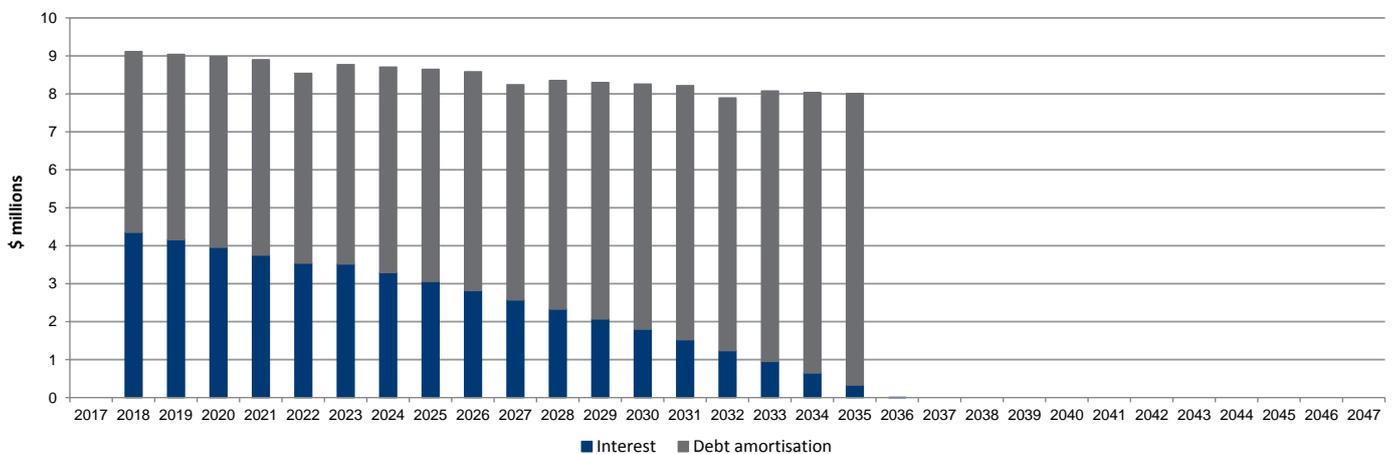
This tax modelling is a conservative element of our assumptions. We understand GNX will employ a stapled security structure similar to those employed by REITs and infrastructure stocks. This tax efficient structure passes the tax obligation through to the investor. Assuming zero tax paid by the solar project adds 150bps to our equity IRR estimate and about 40% to our NPV estimate.

- Funding:** The benefit of the Queensland Government revenue contract (the Government has a AA credit rating) is that the project should be able to fund a high proportion of construction costs with long tenor, cost competitive project finance debt. French bank Societe Generale has been appointed by GNX as its debt funding advisor for the project.

We assume the project will be able to borrow over \$100m while achieving a 1.25x debt service cover ratio. This gearing, combined with the \$8.8m ARENA grant funding and pre-completion operating cashflows, should minimise equity funding requirements. We assume \$10-11m will be required for project equity funding.

Post-completion, we expect amortisation of senior debt to commence immediately, with the strategy being that the debt is fully repaid with a two-year tail prior to expiry of the Queensland Government contract. Thus, the project is assumed to have no debt for the final 12 years of its life.

Figure 6: Kidston solar project debt service forecast

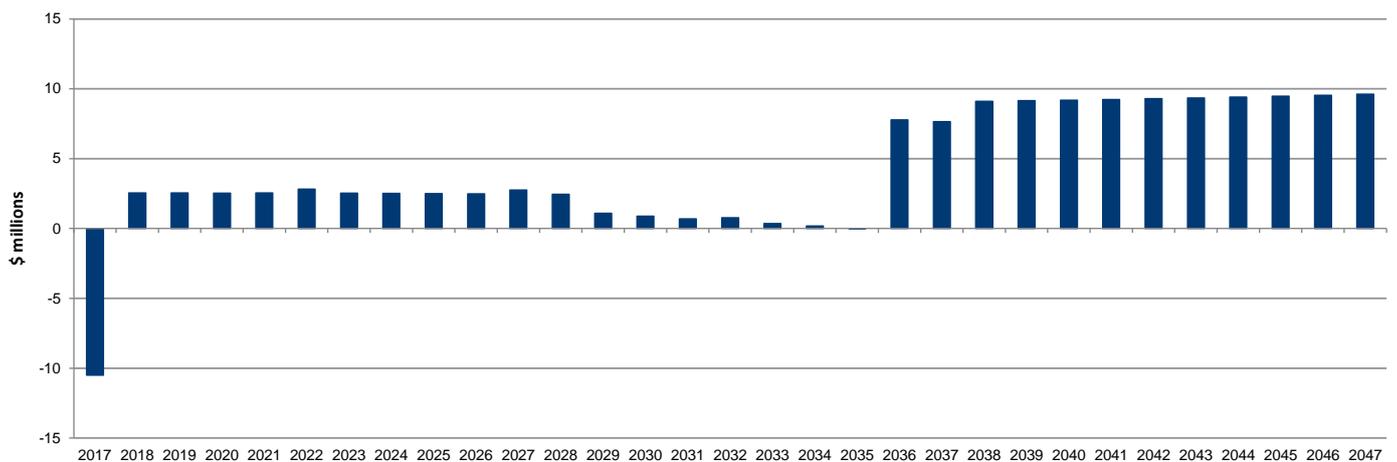


SOURCE: MORGANS

- Equity returns:** Given the EBITDA, debt service and tax profiles discussed above, we derive the equity cashflow profile in the following chart across the project life. Equity cashflow in early years of the project life is ~\$2-3m per year, compared to an assumed equity contribution of ~\$10m. Cashflow is negatively impacted with the commencement of tax payments. Cashflow then steps up materially following full repayment of the project finance debt in 2035 and the expiry of the Queensland Government PPA (with higher assumed spot prices at that time).

Note our modelling assumes no terminal value for the project in 2047.

Figure 7: Kidston solar project equity cashflow forecast



SOURCE: MORGANS

## Company overview

Genex Power (GNX) is a power generation development company based in Australia, focused on developing large-scale renewable energy and energy storage projects at its Kidston site located 300km north-west of Townsville in north Queensland.

## Financial position

As at 30 June 2016, GNX had \$8m of cash. Of this amount, \$3.8m is committed to a bank guarantee to support an environmental bond, thus \$4.2m of unrestricted cash.

GNX says it has revenue tax losses of \$7.1m, which are available to offset future taxable income, subject to meeting the relevant statutory tests.

GNX has a \$2.2m R&D loan with the Commonwealth Bank, which is based on 90% of the anticipated R&D refund for FY16. The facility is priced at BBSY+3.25% pa.

GNX is the recipient of up to \$4m of funding from ARENA (\$2.1m drawn as at 30 June 2016) for studies into the pumped hydro project. The funding is provided by ARENA via unsecured notes that are zero coupon, convertible at 20 cps or redeemable by GNX at face value for a period of five years. Redemption is mandatory upon financial close of the PSP. If not redeemed or converted within five years, the notes may lapse and not be repayable by GNX.

## Pumped hydro storage project

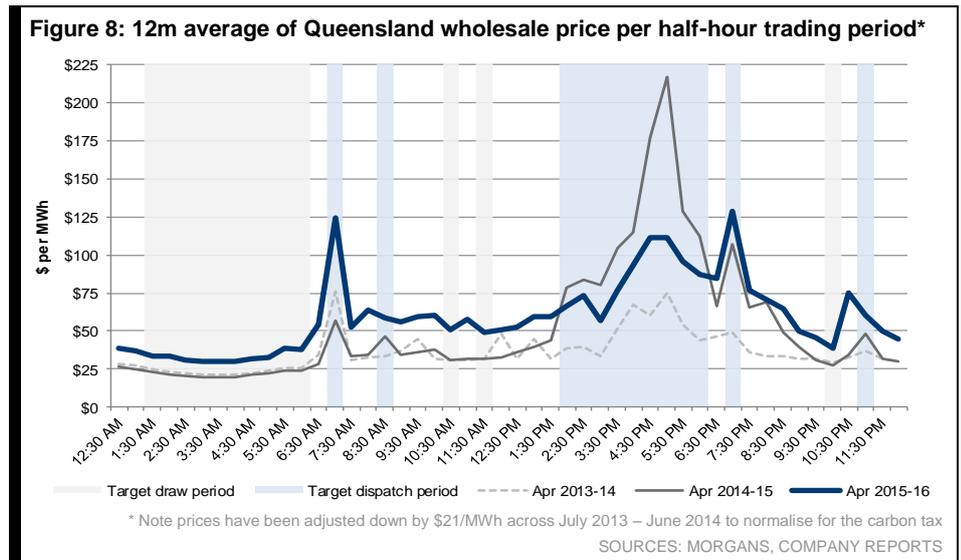
GNX's flagship project is the proposed Kidston pumped storage hydro project located in northern Queensland.

GNX believes the project can take advantage of the increased volatility in wholesale power prices caused by: (i) oversupply of baseload generation capacity, (ii) escalating peak power prices driven by increasing gas turbine fuel costs, and (iii) more renewables in the generation mix.

The general operation of the project will be to sell power to the grid during high price periods (releasing water from the upper reservoir through the generator to the lower reservoir) and buy power from the grid during low price periods (pumping water from the lower to upper reservoir). Thus, project economics are driven by the level and spread of prices between high price periods and low price periods. The greater the spread the better for the project, and vice versa.

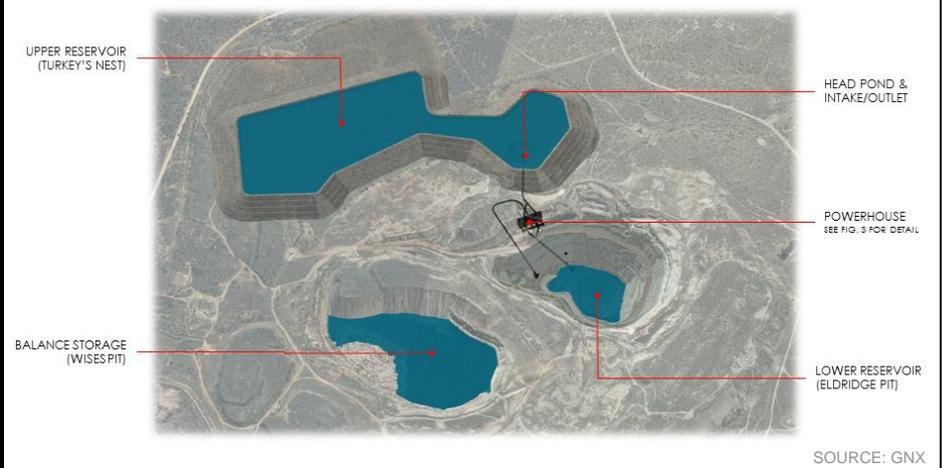
The following chart shows the average Queensland wholesale power price per half-hour trading period in a 24-hour period for each 12-month period ending 30 June 2014, 2015, and 2016. The shading shows the periods that GNX indicated in its IPO prospectus that it would draw electricity from the market to pump water from its lower reservoir to higher reservoir, and which periods it planned to dispatch power via releasing water from its upper to lower reservoir.

Over the last 12 months, pricing dynamics have weakened as prices in targeted draw periods have risen, while dispatch period pricing has generally weakened. However, the ultimate operation of the plant and the prices that GNX receives and pays will depend on its contracting strategy; it may enter a fixed price contract to buy power, and a mix of merchant sales and sale of cap contracts with respect to its revenues.



A critical element to the project’s success is the construction of a new 275kV transmission line that will connect the site to the National Electricity Market. Without this transmission line, the project has no way of monetising the power it generates. GNX says it is currently in discussions about innovative funding arrangements in respect to the power transmission line. We note that the chairman of GNX is also on the board of ASX-listed Victorian energy utility AusNet Services (ASX: AST), thus providing GNX with expertise in these discussions.

The project’s BFS is due to be completed in Q3 2016, and thus far GNX reports that no fatal flaws have been found. The focus of the BFS is on optimisation of the design, including generation capacity sizing. The project was originally expected to have a capacity of 330MW (three units at 110MW each), but now capacity is being considered at up to 450MW to generate for more than five hours.

**Figure 9: Revised PSP scheme layout**

The project design being considered includes building a new upper reservoir at the waste rock dump, with the existing upper pit being utilised for excess water storage and water balancing. GNX is confident it can deliver the project at a cost of around \$1m per MW.

In order to deliver this project GNX is considering partnering with an integrated generator and retailer in the Queensland market.

GNX says it has clear visibility of available debt, equity and other funding alternatives and financing structures. For instance, it may be able to access the Commonwealth Government's Northern Australia Infrastructure Facility, which offers concessional debt pricing and tenor.

First generation is targeted for late 2019.

## Board and senior management

The board and management have a complementary skill set and experience combining engineering, project finance, electricity generation and management of Australia's second largest pumped storage hydro power station – Wivenhoe Dam.

**Figure 10: Summary of Directors and Executives**

Name	Position	Background	Shares (k)	Options (k)
Dr Ralph Craven	Non-Executive Chairman	Former CEO and Chairman of Ergon Energy and CEO of Transpower NZ. Chairman of Stanwell Corporation. Non-executive director at Senex Energy and AusNet Services.	250	3,000
Alan du Mee	Non-Executive Independent Director	Former CEO of Tarong Energy (now part of Stanwell Corporation)	200	2,000
Michael Addison	Managing Director	Founder of EndoCoal and Carabella Resources. Water engineer with extensive finance experience.	27,500	1,000
Simon Kidston	Executive Director	Founder of EndoCoal and Carabella Resources. Former banker with HSBC, Macquarie, and Helmsec.	20,720	1,000
Yongqing Yu	Non Executive Director	Vice Chairman of Zhifu		
Ben Guo	Finance Director	10 yrs experience with PWC, E&Y, Helmsec, and Carabella Resources.	2,040	1,000
Arran McGhie	COO General Manager	20 years experience in senior project management roles for underground excavation and civil construction projects		5,000
James Harding	Executive General Manager			2,400
Justin Clyne	Company Secretary / Legal Counsel	Experienced lawyer and company secretary		

SOURCES: MORGANS, COMPANY REPORTS

## Key milestones and targets

The table below summarises the key milestones and targets for the company.

**Figure 11: Summary of key milestones and timing targets**

Date	Description
<b>Milestones Achieved</b>	
04-Jun-14	Acquisition of Kidston Gold Mines from Barrick Gold (including Kidston project site). Genex was required to assume environmental management of the site as well as replace an existing environmental assurance bond with the Queensland Government (totals \$3.8m).
Dec-14	Completion of the Kidston pumped storage hydro project pre-feasibility study.
08-Jul-15	Listing on ASX.
10-Aug-15	Appointed Hyro Tasmania-subsiary Entura to deliver Bankable Feasibility Study (BFS) for its Kidston pumped storage hydro project in north Qld. Target completion of the BFS is 30 June 2016. In September 2015, the target BFS completion timing was revised to Q3 2016.
08-Oct-15	Feasibility study commenced for 150MW Kidston Solar Project.
18-Dec-15	Secured \$4m in funding from ARENA, payable in instalments as conditions are met with respect to the pumped hydro storage project.
14-Jan-16	Successful in Expressions of Interest for ARENA's large-scale solar funding award program.
18-Jan-16	Received freehold ownership of Kidston Project Site.
02-Feb-16	Received development approval for Kidston Solar PV Project.
03-Mar-16	Kidston pumped storage project declared a 'Prescribed Project' by the Queensland Government, which provides benefits such as intervention throughout approval process and assistance in unexpected delays.
Apr-16	Completion of Kidston Solar PV BFS.
05-May-16	Received environmental approval for the Kidston Solar Project.
10-May-16	Executed a Connection Agreement with Ergon Energy for the Kidston Solar Project.
16-May-16	Entered into a debt funding mandate with Societe Generale in respect of the solar project. The bank is to act as sole lead arranger and financial advisor with respect to the project financing.
07-Jun-16	Appoints AECOM as Owners Engineer for the Kidston Solar Project
22-Jun-16	UGL appointed as preferred EPC and O&M contactor for the Kidston Solar Project
15-Sep-16	First Solar appointed as PV module supplier for Kidston Solar Project
<b>Upcoming Milestones</b>	
<b>Solar PV project</b>	
4Q 2016	Targeted financial close.
4Q 2017	Targeted first generation.
<b>Pumped hydro storage project</b>	
3Q 2016	Targeted completion of BFS.
4Q 2019	Targeted first generation.

SOURCES: MORGANS, COMPANY REPORTS

## Shareholders

GNX has 180m shares on issue, of which 60.2m are subject to escrow until 8 July 2017.

Board and management hold 33% of shares on issue, Zhefu Hydropower 17.6%, institutional investors 12%, and the remaining 37% by other investors.

GNX has the following options on issue:

- 8.5m exercisable at 25c each expiring 7 February 2019 (8.0m are subject to escrow until 8 July 2017);
- 17.3m exercisable at 20c each expiring 25 February 2018;
- 5.0m options exercisable at 25c each expiring 6 August 2020 (not subject to escrow but with various vesting milestones);
- 5.0m options exercisable at 25c each expiring 2 September 2021 (not subject to escrow but with various vesting milestones); and
- Convertible notes under the ARENA grant funding for the pumped storage project.

## Key risks

- Securing power purchase agreements (PPA) with creditworthy counterparties for a sufficient term and adequate price to deliver an appealing economic return. This risk on the initial 50MW solar project has been mitigated through the Queensland Government contract discussed in this note.
- Uncontracted or merchant output is exposed to spot Queensland wholesale power prices.
- Plant capacity factor, which is partly dependent on the solar resource and plant and transmission availability.
- Annual changes by the market operator of transmission and distribution loss factors.
- Operating cost overruns.
- Construction cost overruns and/or delays.
- Sourcing competitive term debt, which is highly dependent on the quality of the PPA.
- Dilution from capital raisings to fund working capital and/or capital investments.
- Government policy supporting renewable projects, including ARENA and the Renewable Energy Target.

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