

# Genex Power

## SPECULATIVE BUY

(no change)

Current price:	A\$0.215
Target price:	A\$0.36
Previous target:	A\$0.37
Up/downside:	67.4%
Reuters:	GNX.AX
Bloomberg:	GNX AU
Market cap:	US\$77.78m
	A\$107.2m
Average daily turnover:	US\$0.14m
	A\$0.19m
Current shares o/s	401.8m
Free float:	69.3%

### Key changes in this note

FY21F shares outstanding increased by 32%



Price performance	1M	3M	12M
Absolute (%)	-17.3	4.9	-6.5
Relative (%)	-18.7	-1.2	-1.2

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

– Genex Power

## September is the month for key catalysts

- FY20 revenue beat our expectation (+15%) while pre-tax loss slightly missed our forecast (-3%).
- Jemalong's first energy expected late 2Q21 and commissioning completed in 3Q21.
- Financial close on K2-H should be achieved when a JV partner is selected and the Queensland Government confirms a funding package for the transmission line.
- The Como battery project is early stage but offers upside potential to our target.
- We maintain our SPECULATIVE BUY rating but reduce our price target to 36cps.

### FY20 revenue beat but slight miss on pre-tax loss

The higher than expected revenue was offset by higher expenses although it should be noted that some of these costs do not, in our opinion, reflect the underlying profitability of the business. GNX expensed \$1.7m more on K2H development than we'd expected which presumably will be recouped through the execution of the JV agreement. Additionally the \$2.3m in share based payment expenses represents an increase in the fair value of previously granted management options. If the results were adjusted for those items then they would have beaten our expectations.

### Project pipeline moving forwards

GNX expects that Jemalong will produce first energy late in 2QFY21 with commissioning complete by April 2021. We understand that practical completion and the significant majority of capital expenditure is expected to be complete during 3QFY21 though. GNX is continuing to progress the two major outstanding items before financial close on the Kidston pumped hydro project (K2-H). We anticipate there will be confirmation on a joint venture partner for K2-H and state government funding for the transmission line before 30 September 2020.

### Capital raising opens the door for Como

We were anticipating that GNX would raise some additional funds for working capital but the announcement of the battery project came as a surprise. Batteries will become an increasingly important part of the technology mix in the grid. The limited number of grid scale batteries so far in the National Electricity Market (NEM) has been important in providing grid stabilisation services which have earned them more revenue than energy arbitrage has. We don't have much detail yet on how the project would be commercially structured so we're not yet factoring the project into our valuation but it offers upside.

### Big catalyst drawing closer which could close the valuation gap

The major catalyst continues to be financial close on K2-H which we think will significantly close the gap between the share price and our target price. It's possible that an announcement on the JV partner for K2-H could come ahead of closure on the transmission line funding however we think the market will want to see all of the pieces of the puzzle come together before a rerate. If there is a delay to the transmission line the timing of the Queensland election would be problematic and could cause financial close to be pushed back into late 2Q or early 3Q in FY21. We retain our SPECULATIVE BUY rating and update our base case valuation and price target to 36cps (-3%). Our updated bull case target is 59cps (+5%) while our bear case is 23cps (-4%).

Financial Summary	Jun-19A	Jun-20A	Jun-21F	Jun-22F	Jun-23F
Revenue (A\$m)	10.82	10.25	19.34	21.42	20.57
Operating EBITDA (A\$m)	5.59	1.77	13.43	15.07	14.09
Net Profit (A\$m)	-9.17	-19.98	1.82	1.89	1.33
Normalised EPS (A\$)	(0.030)	(0.050)	0.005	0.005	0.003
Normalised EPS Growth	19.5%	67.2%		1.8%	(29.9%)
FD Normalised P/E (x)	NA	NA	39.83	43.63	62.20
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	29.7	118.1	18.8	16.2	16.6
P/FCFE (x)	NA	1.86	NA	37.64	49.87
Net Gearing	1187%	1077%	356%	314%	280%
P/BV (x)	7.95	7.59	2.89	2.76	2.67
ROE	(77%)	(202%)	10%	6%	4%
% Change In Normalised EPS Estimates			286%	194%	4311%
Normalised EPS/consensus EPS (x)			-1.61	1.23	

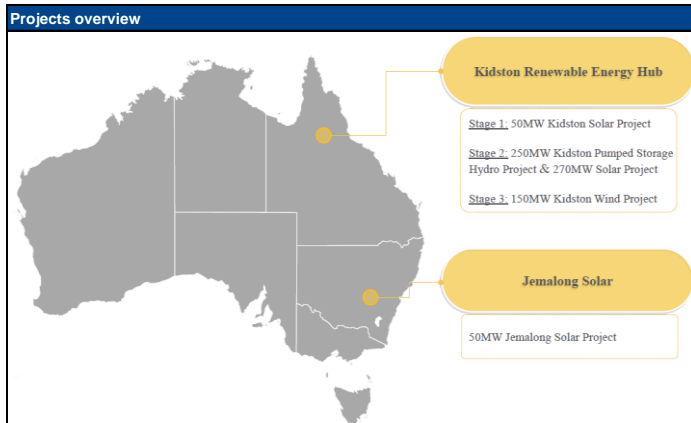
**Genex Power**

as at August 28, 2020

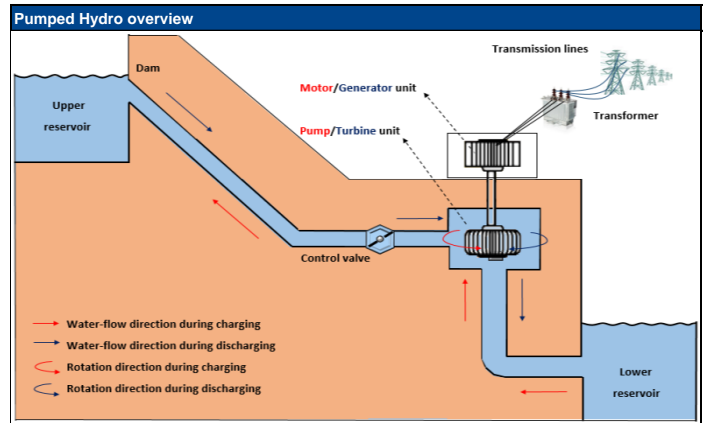
Market cap (A\$m):	107.2	Rating:	SPECULATIVE BUY
Shares outstanding (m):	401.8	Price (A\$):	0.215
Free float (%):	69.3	Target price (A\$):	0.36
Website:	<a href="https://www.genexpower.com.au/">https://www.genexpower.com.au/</a>	Upside/downside to target price (%):	67.4

**Company description**

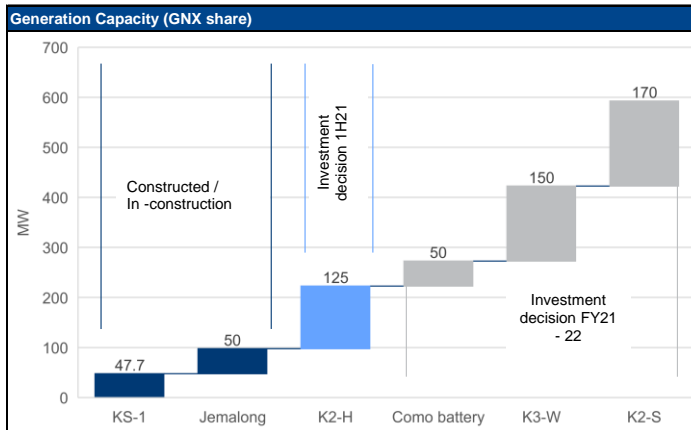
GNX is redeveloping an old gold mine in North Queensland into an energy storage project and has developed a 50MW solar farm adjacent to the mine. GNX also has a second 50MW solar farm under construction at Jemalong in Central NSW as well as plans to expand with a possible second stage solar farm up to 270MW and a potential 150MW wind farm near the Kidston site. The output of the existing Kidston 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, the Kidston site acquired in 2014 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.



SOURCE: GNX



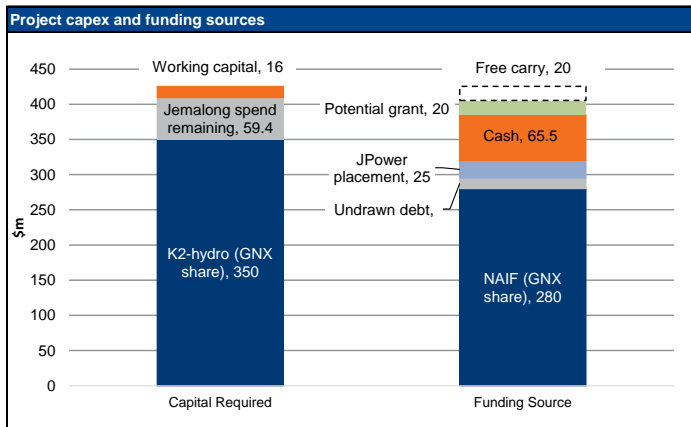
SOURCE: Journal of Power Technologies (2017)



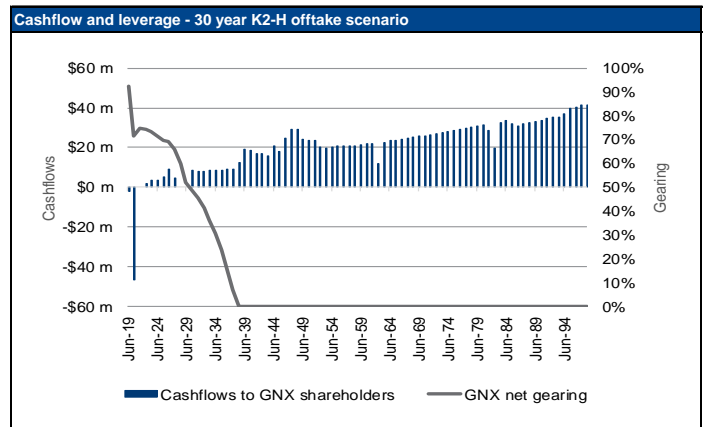
SOURCES: MORGANS, GNX

- 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.
  - Pricing of K2-H offtake agreement.
  - The Como project offers upside potential to our valuation.
- Risks:**
- Pumped hydro joint venture agreement not yet finalised.
  - Queensland Government commitment to partially fund the K2-H transmission line not yet finalised.
  - Cost to access new transmission line for K2-H pumped hydro project.
  - 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 and K2-H.
  - Technological changes driving energy efficiency and alternative generation.
  - Interest rates.
  - Changes to tax regimes.

SOURCE: MORGANS



SOURCES: MORGANS, GNX



SOURCE: MORGANS

Figure 1: Financial summary (ex K2-H and Como)

Key multiples & gearing	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
EV/EBITDA (x)	N/A	30.0	118.3	19.0	16.2	16.6	16.7	15.9	15.5	14.7	14.1
Price-to-earnings (x)	N/A	N/A	N/A	N/A	11	16.2	22.0	17.9	17.2	14.0	12.3
Dividend yield (%)	-	-	-	-	-	-	-	-	2.6	2.7	2.8
Net Debt / ND+E (%)	85.6	92.2	91.5	78.1	75.8	73.7	71.6	69.1	68.4	67.5	66.3
Profit and loss (\$m)	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
Net Revenue	8.3	10.8	10.3	19.3	21.4	20.6	20.0	20.3	20.3	20.6	20.9
Other inc	1.7	4.8	2.0	-	-	-	-	-	-	-	-
Expenses	(11.7)	(10.0)	(10.5)	(5.9)	(6.4)	(6.5)	(6.6)	(6.7)	(6.9)	(7.0)	(7.2)
EBITDA	(1.7)	5.6	1.8	13.4	15.1	14.1	13.4	13.5	13.4	13.6	13.7
D&A	(3.0)	(6.4)	(8.0)	(7.2)	(8.8)	(8.8)	(8.8)	(8.8)	(8.8)	(8.8)	(8.8)
Operating EBIT	(4.7)	(0.8)	(6.2)	6.2	6.3	5.3	4.7	4.8	4.6	4.9	5.0
Net Interest Expense	(2.7)	(4.7)	(4.3)	(3.7)	(3.7)	(3.5)	(3.3)	(3.1)	(2.9)	(2.7)	(2.5)
K2H equity accounted profit	-	-	-	-	-	-	-	-	-	-	-
Profit Before Tax	(7.5)	(5.5)	(10.5)	2.5	2.6	1.8	1.3	1.7	1.7	2.1	2.4
Tax	-	-	-	(0.7)	(0.7)	(0.5)	(0.4)	(0.5)	(0.5)	(0.6)	(0.7)
Statutory Net Profit	(7.5)	(5.5)	(10.5)	1.8	1.9	1.3	1.0	1.2	1.2	1.5	1.7
Cashflows (\$m)	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
EBITDA	(1.7)	5.6	1.8	13.4	15.1	14.1	13.4	13.5	13.4	13.6	13.7
K2H SPV distributions	-	-	-	-	-	-	-	-	-	-	-
WC & non-cash adjustments	(0.5)	(0.8)	(2.5)	(20.5)	0.0	0.1	(0.5)	(0.0)	0.0	(0.0)	(0.0)
Gross operating cashflow	(2.2)	4.8	(0.8)	(7.1)	15.1	14.1	13.0	13.5	13.4	13.6	13.7
Net interest paid	(3.9)	(4.3)	(3.4)	(3.7)	(3.7)	(3.5)	(3.3)	(3.1)	(2.9)	(2.7)	(2.5)
Cash paid for Tax	-	-	-	(0.7)	(0.7)	(0.5)	(0.4)	(0.5)	(0.5)	(0.6)	(0.7)
<b>Operating cashflow</b>	<b>(6.1)</b>	<b>0.5</b>	<b>(4.1)</b>	<b>(11.5)</b>	<b>10.7</b>	<b>10.1</b>	<b>9.3</b>	<b>9.9</b>	<b>10.0</b>	<b>10.3</b>	<b>10.5</b>
Capex	(83.0)	(12.2)	(38.0)	(32.8)	-	-	-	-	-	-	-
<b>Investing cashflow</b>	<b>(83.0)</b>	<b>(12.2)</b>	<b>(38.0)</b>	<b>(32.8)</b>	-	-	-	-	-	-	-
Equity issuance/(returns)	3.2	1.9	20.6	26.3	-	-	-	-	-	-	-
Debt drawdown/(repaid)	85.1	2.3	83.5	(2.9)	(7.7)	(7.9)	(7.8)	(8.4)	(8.6)	(8.8)	(9.1)
Dividends paid	-	-	-	-	-	-	-	-	(3.0)	(3.1)	(3.1)
<b>Financing cashflow</b>	<b>88.3</b>	<b>4.3</b>	<b>104.1</b>	<b>23.3</b>	<b>(7.7)</b>	<b>(7.9)</b>	<b>(7.8)</b>	<b>(8.4)</b>	<b>(11.6)</b>	<b>(11.9)</b>	<b>(12.2)</b>
<b>Net cashflow</b>	<b>(0.7)</b>	<b>(7.4)</b>	<b>62.0</b>	<b>(20.9)</b>	<b>3.0</b>	<b>2.3</b>	<b>1.4</b>	<b>1.6</b>	<b>(1.6)</b>	<b>(1.6)</b>	<b>(1.7)</b>
Balance sheet (\$m)	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
Cash	11.0	3.5	65.5	44.5	47.6	49.9	51.3	52.9	51.3	49.7	48.0
Receivables	0.9	2.0	3.5	1.0	0.9	0.9	1.7	1.8	1.8	1.8	1.8
Fixed Assets	118.2	118.1	170.7	193.1	184.3	175.6	166.8	158.1	149.4	140.6	131.9
SPV equity	-	-	-	-	-	-	-	-	-	-	-
Tax assets	-	-	-	-	-	-	-	-	-	-	-
Other	5.6	11.0	14.2	17.5	17.5	17.5	17.4	17.4	17.4	17.4	17.4
<b>Total Assets</b>	<b>135.6</b>	<b>134.5</b>	<b>253.9</b>	<b>256.1</b>	<b>250.3</b>	<b>243.8</b>	<b>237.3</b>	<b>230.2</b>	<b>219.9</b>	<b>209.5</b>	<b>199.1</b>
Debt	102.1	103.7	188.0	185.1	177.5	169.6	161.8	153.4	144.8	136.0	126.9
Deferred Tax from SPV)	-	-	-	-	-	-	-	-	-	-	-
Other liabilities	18.3	22.4	54.5	31.5	31.5	31.5	31.9	31.9	31.9	31.9	31.9
<b>Total Liabilities</b>	<b>120.4</b>	<b>126.1</b>	<b>242.5</b>	<b>216.6</b>	<b>208.9</b>	<b>201.1</b>	<b>193.6</b>	<b>185.3</b>	<b>176.7</b>	<b>167.9</b>	<b>158.9</b>
<b>Net Assets</b>	<b>15.3</b>	<b>8.4</b>	<b>11.4</b>	<b>39.5</b>	<b>41.4</b>	<b>42.7</b>	<b>43.7</b>	<b>44.9</b>	<b>43.1</b>	<b>41.6</b>	<b>40.2</b>
<b>Ave shares on issue (m)</b>	<b>303.9</b>	<b>312.4</b>	<b>401.8</b>	<b>530.4</b>	<b>530.4</b>	<b>530.4</b>	<b>530.4</b>	<b>530.4</b>	<b>530.4</b>	<b>530.4</b>	<b>530.4</b>

SOURCE: MORGANS RESEARCH, COMPANY

## A primer on batteries

### How do batteries make money?

Batteries can earn revenue in some of the same ways that pumped hydro can but because of the comparatively shallower storage and much faster dispatch times, recent battery projects have made most of their revenue from the ancillary services market. At times when regions of the NEM become electrically separated due to weakness of interstate connectors batteries have been able to earn very high profits but the timing of these events is obviously not predictable.

Frequency Control and Ancillary Services (FCAS) are grid support services that keep the frequency of the electricity supply within its required technical limits. The NEM currently uses raise and lower services over four different time periods to give a total of eight different FCAS services that participants bid to provide. Watt Clarity have written an excellent article (<http://www.wattclarity.com.au/articles/2017/03/lets-talk-about-fcas/>) that provides an overview of FCAS.

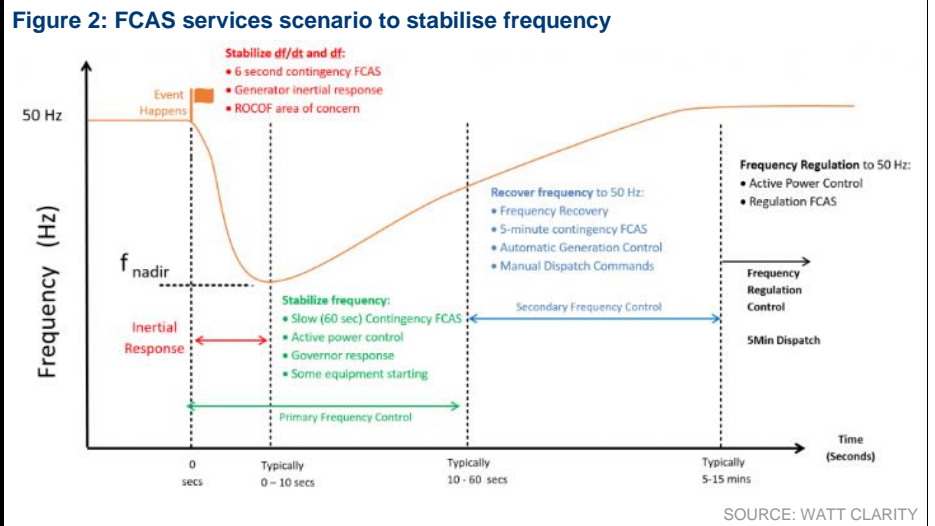
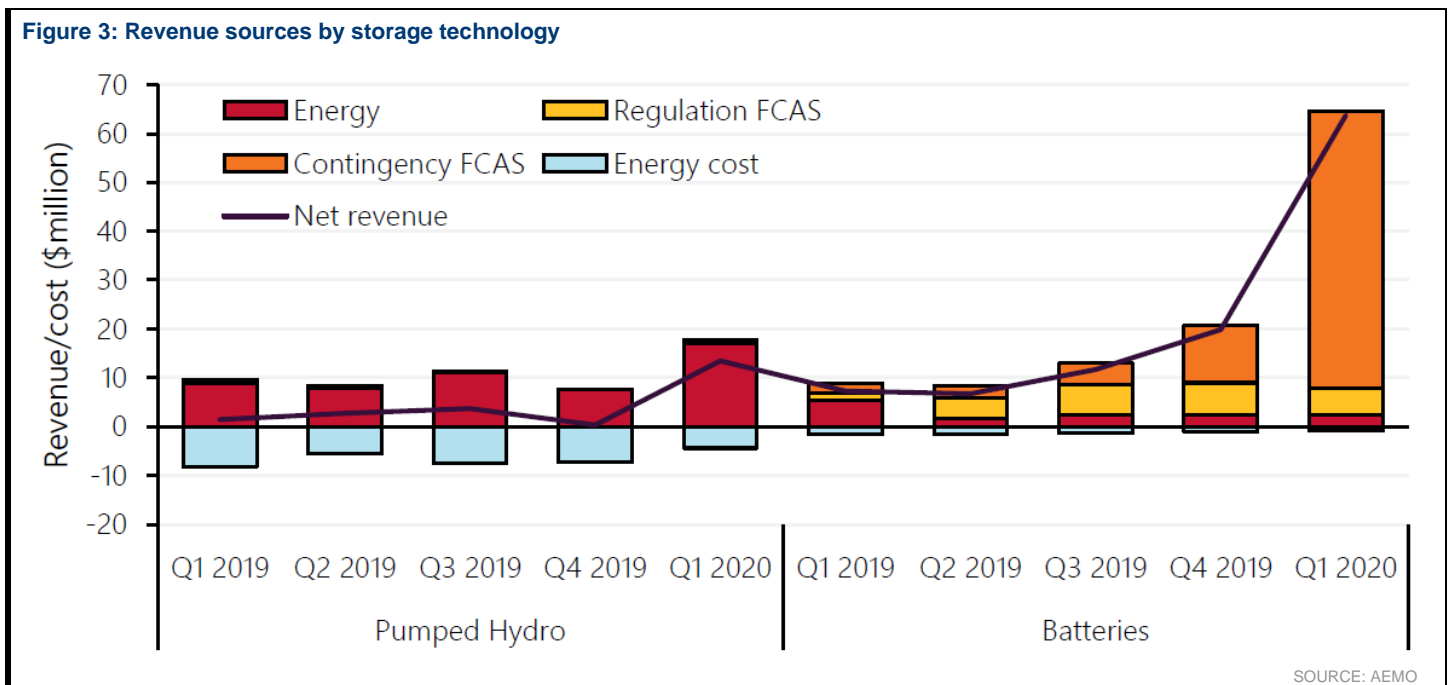


Figure 3: Revenue sources by storage technology

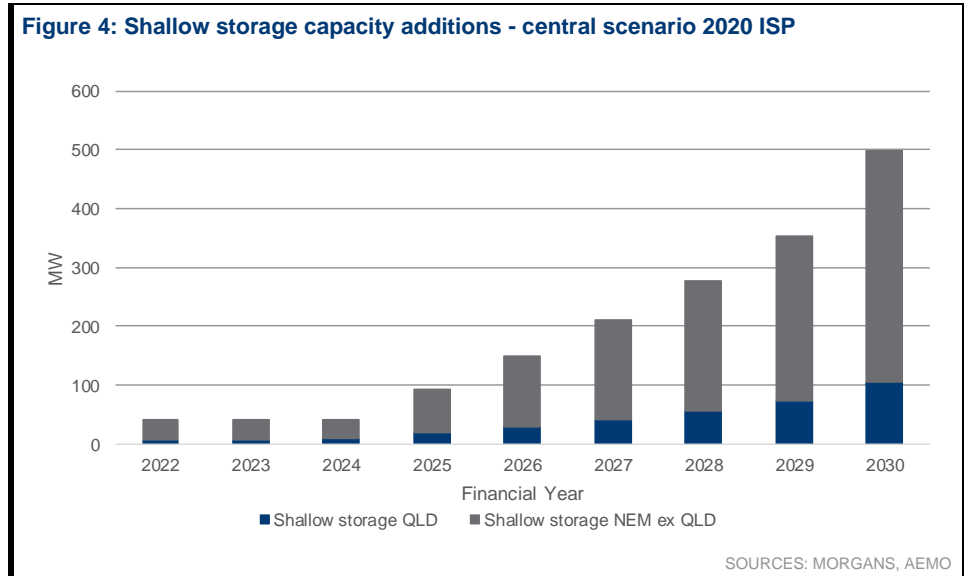


### What does the competitive landscape look like?

GNX is not alone in looking to develop grid-scale battery projects and the latest Integrated System Plan (ISP) developed by the Australian Energy Market Operator (AEMO) points to the need for large investments in storage to support Variable Renewable Energy (VRE) generation like wind and solar. Storage assets of less than 4 hours capacity are defined by AEMO as 'shallow storage'. The ISP forecasts no growth in capacity until 2025 and then batteries are forecast to become relied upon increasingly to firm up the NEM. In the ISP forecast then, the

Como project would face little competition from new entrants for the first few years of its life for FCAS revenue. As time progresses there would be increasing competition but also a much larger market as more renewable energy plants are built and coal plant retirements accelerate in the 2030s.

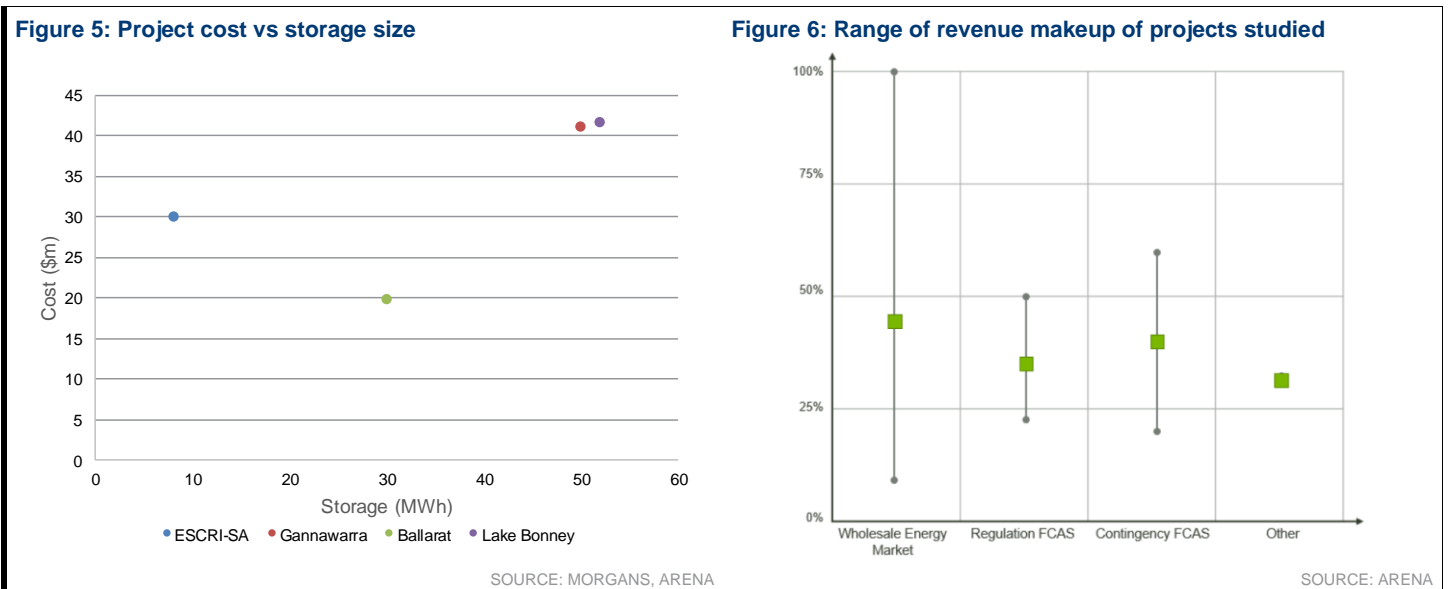
**Figure 4: Shallow storage capacity additions - central scenario 2020 ISP**



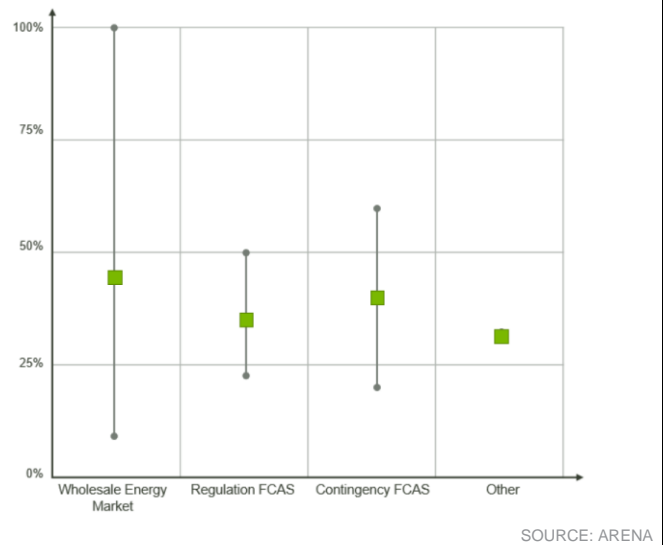
**Project case studies**

A number of grid scale batteries has been installed in the NEM in recent years, with most installed in southern states like South Australia and Victoria. Most projects have between 1-2 hours of storage based on nameplate capacities. ARENA’s 2019 large scale battery storage knowledge sharing report identifies capital costs and revenue make-up of four different battery projects that were constructed between 2018 – 2019. Most projects had made the majority of their revenue from FCAS.

**Figure 5: Project cost vs storage size**



**Figure 6: Range of revenue makeup of projects studied**



## Valuation and risks

### Base case

We have updated a number of key assumptions for K2-H in our base case DCF. Our new base case DCF valuation is 37cps (-5cps) which we combine with our asset based valuation of 35cps (+4cps) to give our new **base case valuation of 36cps** (-1cps). The increase in our asset based valuation is primarily driven by a change of multiple. Instead of using a multiple based on gas projects we are using the one recent Australian transaction involving hydro assets that we're aware of. Pacific Hydro was acquired in 2015 at a multiple of \$3.3m / MW.

Key assumptions in our DCF:

- Forecast shares outstanding increased to 530.4m assuming full take up of the rights issue.
- \$21.5m pa is GNX's share of EBITDA (indexed with inflation).
- 2.85% after tax WACC based on Rd of 2.25%, Re of 8% and gearing of 80%.
- Total project capital of \$700m for K2-H (EPC contract + owner's costs + transmission line contribution).
- \$310m GNX share of capex after \$40m in grants to the JV and a \$20m JV free carry for GNX.
- 80 year asset life.
- Refurbishment after 50 years costing 50% of the initial engineering contract (\$275m in FY21 terms) and increased in line with inflation.
- 25% risking factor after allowing for dilution given the requirement for additional \$25m equity from JPower (previously \$30m assumed).

Key changes to assumptions in our asset based multiple valuation:

- K2-H successfully completed and valued at transaction multiple of Pacific Hydro (\$3.3m / MW).
- K2-H equity value discounted by 4 years to allow for construction period.

**Figure 7: Base case sum of the parts**

Component	Value (\$m)	Value (cps)
KS1 & Jemalong	51.9	10
Corporate	-19.1	(4)
GNX K2H value	141.3	27
K2-S & K3-W	20.5	4
<b>Total</b>	<b>194.5</b>	<b>37</b>

SOURCE: MORGANS

**Figure 8: Base case asset multiple**

Asset	MW	Multiple (\$ / W)	EV (\$m)	Net Debt (\$m)	Equity (\$m)	Discounted Equity (\$m)
Jemalong + KS1	97.7	2.4	234.5	(140.6)	93.9	93.9
K2-H	125	3.3	412.5	(264.0)	148.5	109.2
K2-S + K3-W	320	0.1	19.7	-	19.7	19.7
<b>Total</b>	<b>542.7</b>	<b>1.2</b>	<b>666.7</b>	<b>(404.6)</b>	<b>262.1</b>	<b>222.8</b>
<b>Number of shares</b>						<b>644.0</b>
<b>Discounted equity value (cps)</b>						<b>35</b>

SOURCE: MORGANS

### Key risks to our base case valuation:

- Successful K2-H financial close by 30 September 2020: GNX has had to postpone financial close on K2-H once before when renegotiating the offtake agreement with EnergyAustralia. If there is a delay to the joint venture agreement or to the Queensland Government committing to funding for the transmission line then a number of key conditionally approved agreements, such as the offtake agreement, NAIF credit approval, EPC contract, will expire and need to be repriced or renegotiated.
- GNX's share of EBITDA: we've estimated EBITDA from our own analysis of the fair value for energy storage (based on historical electricity market data) and operation expenses in AEMO's modelling assumptions (\$19.50/kW/yr).

K2-H's offtake customer, EnergyAustralia, may have struck a contract below our estimate of fair value and AEMO's assumptions for opex may not be accurate for K2-H.

- ARENA grant: As K2-H will be a highly geared asset, the rate of return will be highly sensitive to the amount of capex required from the JV. We're confident that the project will receive funding but it is not certain.
- JV 'free carry': It's logical that GNX would be reimbursed for the value it has created so far in securing land, early engineering work, progressing commercial agreements, etc however it is hard to gauge how this negotiation will play out. The amount of free carry will determine how much capital GNX needs to contribute to the JV and could be an even bigger influence on returns to GNX shareholders than the ARENA grant.
- Debt amortisation: we haven't attempted yet to model accelerated debt repayments which may be required under the NAIF agreement. GNX may be required to limit dividends in the first ten years of the offtake agreement to reduce NAIF's exposure should EA not exercise its option to continue the offtake contract. We anticipate more information will be available at K2-H financial close to better allow for this possibility.

### Bull case

In line with the updates to our base case we also update the DCF assumptions for our bull case to give a reduced valuation of 45cps (-9cps), mostly as a result of the increased shares on issue. We continue to use a takeover scenario in our bull case asset based valuation but we increase our valuation on the assumption that K2-H is valued at the same multiple as Pacific Hydro and a reduced future number of shares needed to fund K2-S and K3-W. This brings our valuation to 72cps (+15cps). Our combined **bull case value** is therefore **59cps** (+3cps).

Our key assumptions are:

- No K2-H DCF risking factor other than the allowance for additional equity.
- GNX is acquired by an infrastructure investor in four years' time after the completion of all projects on an asset multiple.
- K2-H valued at the transaction multiple of Pacific Hydro (\$3.3m / MW).
- Other assets are 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 FY21 at 8% pa.

**Figure 9: Bull case sum of the parts**

Component	Value (\$m)	Value (cps)
KS1 & Jemalong	51.9	10
Corporate	-19.1	(4)
GNX K2H value	186.0	35
K2-S & K3-W	20.5	4
<b>Total</b>	<b>239.2</b>	<b>45</b>

SOURCE: MORGANS

**Figure 10: Bull case asset multiple**

Asset	MW	Multiple (\$ / W)	EV (\$m)	Net Debt (\$m)	Equity (\$m)
Jemalong + KS1	97.7	3.1	302.9	(140.6)	162.3
K2-H	125	3.3	412.5	(264.0)	148.5
K2-S + K3-W	320	3.1	992.0	(440.0)	552.0
<b>Total</b>	<b>542.7</b>	<b>3.1</b>	<b>1,707.4</b>	<b>(844.6)</b>	<b>862.8</b>
<b>Estimated future number of shares (m)</b>					<b>982.2</b>
<b>Discounted equity value (cps)</b>					<b>72</b>

SOURCE: MORGANS

### Bear case

We also update our bear case DCF assumptions which gives us a value of 23cps (-1cps). Our bear case asset based multiple assumption is also slightly reduced to 22cps (-2cps) on an increased future number of shares. Our combined **bear case valuation** is therefore **23cps** (-1cps).

Our key assumptions are:

- K2-H risking factor of 55%.
- Asset multiple is the lowest quartile multiple of comparable transactions (see previous note on 29 May 2019 for list of transactions).
- K2-H not completed and valued as an option similar to the prices discussed for the Hillgrove pumped hydro project in South Australia.

**Figure 11: Bear case sum of the parts**

Component	Value (\$m)	Value (cps)
KS1 & Jemalong	51.9	10
Corporate	-19.1	(4)
GNX K2H value	66.9	13
K2-S & K3-W	20.5	4
<b>Total</b>	<b>120.1</b>	<b>23</b>

SOURCE: MORGANS

**Figure 12: Bear case asset multiple**

Asset	MW	Multiple (\$ / W)	EV (\$m)	Net Debt (\$m)	Equity (\$m)
Jemalong + KS1	97.7	2.1	205.2	(140.6)	64.6
K2-H	250	0.1	30.8	-	30.8
K2-S + K3-W	320	0.1	19.7	-	19.7
<b>Total</b>	<b>667.7</b>	<b>0.4</b>	<b>255.6</b>	<b>(140.6)</b>	<b>115.0</b>
<b>Estimated future number of shares</b>					<b>530.4</b>
<b>Discounted equity value (cps)</b>					<b>22</b>

SOURCE: MORGANS



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