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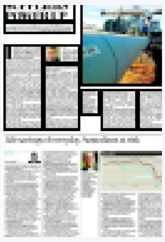

06 APR, 2020
SUPPLIERS POWER UP

Australian Financial Review, Australia

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Energy Electricity and gas utilities and transporters are proving much more resilient to the COVID-19 market shock than some, writes **Angela Macdonald-Smith**.

It's a world of two halves in the energy sector. While oil and gas producers have been slammed by perhaps their biggest ever challenge from COVID-19 and the oil price crash, power and gas utilities are a relative safe haven.

Suppliers and transporters of essential basics such as electricity and gas can count on demand for their products and services even in the worst of downturns. As it turns out, those stocks are so far proving more defensive than the motorway and airport companies that are also tagged with that label.

Utilities lagged only the consumer staples and healthcare sectors in total returns on the sharemarket in March, according to Macquarie Equities, with a 6.7 per cent decline against a broader market drop of 21.5 per cent. The "energy" sector was at the other end of the scale, slumping 37.6 per cent, a dive that would have been steeper but for coal stocks compensating for the plummets in the major oil and gas players that reached 50-55 per cent for worst-hit Santos and Oil Search.

Still, there's a wide variety of performances within utilities. AusNet Services, owner of Victoria's electricity transmission grid, was one of the few ASX-listed stocks that actually managed a gain in its share price through March. Spark Infrastructure and APA Group fell but clawed back the worst of their losses.

APA's new chief executive, Rob Wheals, says the gas pipeline owner is "generally resilient" from the sort of market disruption arising from the the COVID-19 pandemic

and the oil-price shock.

But he cautions that the unprecedented nature of the pandemic and its widespread impacts means the situation will remain "dynamic" and isn't ruling out an impact on customers and suppliers down the track.

"While APA's underlying business remains strong, it is anticipated that prolonged business restrictions in Australia and around the world may result in reduced short to medium term economic activity which could result in the potential deferral by customers of final investment decisions in relation to growth projects," Wheals tells *The Australian Financial Review*.

Still, investor worries about increasing policy risks and a tougher regulatory climate that had increasingly clouded sentiment around such stocks in recent months have paled in the context of the hammer blows from COVID-19 in other sectors that have triggered the flood of withdrawn profit forecasts, job losses and project delays.

Integrated power and gas suppliers such as AGL Energy and Origin Energy are not immune, impacted by the inevitable downturn in demand as parts of the economy shut down.

Italian and Spanish electricity demand has dropped 20 per cent and 10 per cent, respectively, as a result of their lockdowns due to COVID-19, says Morgans analyst Max Vickerson. Though Australia hasn't seen as large a demand drop-off, it is possible if heavy industry reduces its activity, trimming revenue for AGL and Origin.

"Typically electricity retailers would be good defensive assets. However, with the sharp decrease in economic activity required by the response to COVID-19 the sector is not facing typical problems," Vickerson says.

Data on the impact on domestic electricity demand is still emerging but Morgan Stanley analyst Rob Koh found that demand for grid power in the National Electricity Market fell 7 per cent in March, albeit on milder-than-usual weather. That included a 6.6 per cent drop in NSW demand to the lowest March in NEM history, while Victorian demand was down 6.8 per cent, the lowest since 1999, and South Australian demand down 11.1 per cent to a record low.

With COVID-19 restrictions still ramping up, Koh expects demand reduction to accelerate through to June 30. For AGL and Origin, the impact on volumes will likely be greater in the lower margin commercial sector, where small businesses have shut down, Morgan Stanley says. Gains from higher consumer demand due to working from home will likely be offset by higher bad debt provisions.

Perhaps more of a concern is wholesale prices, with daily average spot rates down in the $40s per megawatt-hour range, significantly lower than many previous March periods.

UBS calculates that every $10/MWh drop in wholesale electricity prices could reduce AGL's net profit by 20 per cent in 2020-21.

Origin Energy's gas production and export business makes it the laggard among utilities as it reels from the oil price crash and oversupplied LNG market.

UBS utilities analyst Tom Allen still has a positive call on Origin based on "deep value" from its Northern Territory unconventional exploration project that he acknowledges is a difficult sell to investors at present. The exploration drilling has been suspended until later this year due to COVID-19.

"In terms of defensiveness you can't look past AusNet and APA, which have performed the best," Allen says, pointing to AusNet's 1.5 per cent gain in total returns over the past month. Its revenues have low exposure to changes in energy demand over the next 18 months, as does APA Group's.

"What we like about APA is that not only is it defensive but it also offers earnings growth," he says, estimating that the gas pipeline owner will see 8 per cent compound annual growth in net profit between 2019-20 and 2011-22, while dividends will grow 4 per cent on the same basis.

"In this current market environment, there are not many that can do that."

Similarly, AusNet, which owns transmission and distribution businesses in Victoria and the Mondo renewable plant connection business, is also expected to grow earnings before interest, tax, depreciation and amortisation by 2 per cent on a compound annual basis from 2020 to 2024, and earnings per share by 1.5 per cent, UBS estimates.

"Not particularly significant growth, but importantly it is growth in this market," Allen says.

APA, which only escaped a $13 billion takeover by Hong Kong's Cheung Kong Group thanks to the intervention of Federal Treasurer Josh Frydenberg, has "really rock solid" earnings, Allen says. Some 80 per cent of revenues are from "take or pay" contracts, where the volume of gas flows is immaterial, while a further 10 per cent come from electricity and gas lines controlled by regulated access regimes that mostly protect from volume risk. AFR

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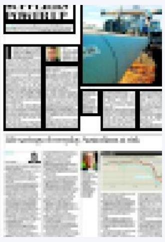

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Gas and electricity transmission tends to ignore market disruptions such as COVID-19.
APA's Rob Wheals, left, is keeping an eagle eye on the impact on suppliers and customers.
PHOTOS: JAMES DAVIES, STEVEN SIEWERT