28 July 2014
Asia Pacific/Australia
Equity Research
Multi Utilities (Utilities (AU))

AGL Energy

(AGK.AX / AGK AU)

Rating	**NEUTRAL***
Price (28 Jul 14, A$)	14.67
Target price (A$)	15.60¹
Market cap. (A$mn)	8,211.09
Yr avg. mthly trading (A$mn)	466
Last month's trading (A$mn)	594
Projected return:	
Capital gain (%)	6.3
Dividend yield (net %)	4.6
Total return (%)	10.9
52-week price range	16.1 - 14.2

** Stock ratings are relative to the relevant country benchmark.*
¹Target price is for 12 months.

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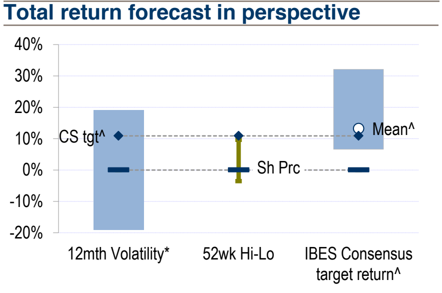
SOCIALLY RESPONSIBLE INVESTING

Rule change positive though risks remain

- **The NSW government has announced plans to modify State planning policy which would allow AGK to hydraulic fracture without the completion of a full environmental impact study (EIS).**
- **What is being proposed:** Under the planned changes, the 3km rule will begin at the geometric centre of the new wells, not the nearest well which is the current requirement.
- **What does this mean for AGK?** The proposed amendments will remove the ambiguity surrounding whether AGK is required to produce an EIS. This removes a potential hurdle that we have cited previously that could have resulted in delays. However, this is not likely to be perceived as transparent or fair among the vocal opponents to the project.
- **Does it matter?** We continue to view the high level of resistance in the Gloucester Valley and surrounds as an ongoing risk for AGK's CSG operations in Gloucester. Avoiding this requirement may lead to the *perception* of a weakening of the approvals process, in our view.
- **We reiterate 2.9% downside included in AGK valuation from ESG issues over Gloucester development:** We believe there is a risk of delay or a 'no go ahead' decision for the Waukivory Pilot Project. We have included only $88mn in value for exploration potential at Gloucester out of the $347.5mn book value (i.e. ~$260mn downside). This is also equivalent to a loss of ~180,000 customers. Our DCF valuation of a development at Gloucester is similar to the AGK book value.

Total return forecast in perspective



Performance over	1M	3M	12M
Absolute (%)	-6.2	-6.0	-0.5
Relative (%)	-8.6	-7.7	-11.1

*Relative performance versus S&P ASX 200. See Reference Appendix for a description of the chart. Source: Credit Suisse estimates, * Consensus, mean range from Thomson Reuters.*

Financial and valuation metrics

Year	06/13A	06/14E	06/15E	06/16E
Revenue (A$mn)	9,715.7	9,811.5	10,133.2	10,354.5
EBITDA (A$mn)	1,336.4	1,344.0	1,557.5	1,745.0
EBIT (A$mn)	1,049.3	1,004.2	1,146.1	1,319.4
Net income (A$mn)	598.3	560.0	659.9	771.1
EPS (CS adj.) (A¢)	108.67	100.31	107.65	115.42
Change from previous EPS (%)	n.a.	—	—	—
Consensus EPS (A¢)	n.a.	101.70	107.70	125.90
EPS growth (%)	8.8	-7.7	7.3	7.2
P/E (x)	13.5	14.6	13.6	12.7
Dividend (A¢)	63.00	65.00	66.62	68.29
Dividend yield (%)	4.3	4.4	4.5	4.7
P/B (x)	1.1	1.1	1.0	1.0
Net debt/equity (%)	38.5	35.0	29.2	20.9

*Source: Company data, ASX, Credit Suisse estimates, * Adj. for goodwill, notional interest and unusual items. Relative P/E against ASX/S&P200 based on pre GW in AUD. Company PE calculation is based on displayed EPS Currency.*

Figure 1: Financial summary

AGL Energy (AGK)

Year ending 30 Jun

In AUDmn, unless otherwise stated

Share Price: A$14.67		7/28/2014 12:26
Rating		NEUTRAL
Target Price	A$	15.60
vs Share price	*%*	*6.34*

AGL Energy is an Australia-based integrated energy retailer. AGL is an integrated renewable energy company and is a private owner, operator and developer of renewable generation assets.

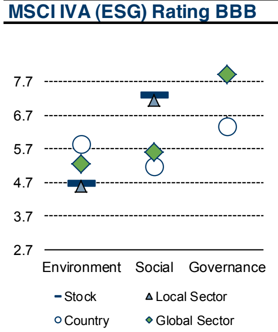
Profit & Loss	06/12A	06/13A	06/14E	06/15E	06/16E
Sales revenue	**7,455.6**	**9,715.7**	**9,811.5**	**10,133.2**	**10,354.5**
EBITDA	**904.3**	**1,336.4**	**1,344.0**	**1,557.5**	**1,745.0**
Depr. & Amort.	(173.9)	(287.1)	(339.9)	(411.4)	(425.6)
EBIT	**730.4**	**1,049.3**	**1,004.2**	**1,146.1**	**1,319.4**
Associates	0.0	0.0	0.0	0.0	0.0
Net interest Exp.	(51.2)	(205.5)	(214.4)	(215.3)	(231.8)
Other	0.0	0.0	0.0	0.0	0.0
Profit before tax	**679.2**	**843.8**	**789.8**	**930.7**	**1,087.5**
Income tax	(197.2)	(245.5)	(229.8)	(270.8)	(316.4)
Profit after tax	**482.0**	**598.3**	**560.0**	**659.9**	**771.1**
Minorities	0.0	0.0	0.0	0.0	0.0
Preferred dividends	0.0	0.0	0.0	0.0	0.0
Associates & Other	0.0	0.0	0.0	0.0	0.0
Normalised NPAT	**482.0**	**598.3**	**560.0**	**659.9**	**771.1**
Unusual item after tax	(367.1)	(209.6)	(46.0)	0.0	0.0
Reported NPAT	**114.9**	**388.7**	**514.0**	**659.9**	**771.1**

Balance Sheet	06/12A	06/13A	06/14E	06/15E	06/16E
Cash & equivalents	1,812.9	281.0	473.4	801.6	1,470.5
Inventories	185.4	133.0	152.0	157.0	160.4
Receivables	1,531.4	1,844.0	1,862.2	1,923.2	1,965.2
Other current assets	602.2	578.0	578.0	578.0	578.0
Current assets	**4,131.9**	**2,836.0**	**3,065.6**	**3,459.9**	**4,174.2**
Property, plant & equip.	6,323.5	6,175.7	6,475.6	8,032.6	7,969.2
Intangibles	3,172.0	3,149.4	3,149.4	3,149.4	3,149.4
Other non-current assets	1,111.0	1,204.7	1,204.7	1,323.7	1,323.7
Non-current assets	**10,606.5**	**10,529.8**	**10,829.7**	**12,505.7**	**12,442.3**
Total assets	**14,738.4**	**13,365.8**	**13,895.3**	**15,965.6**	**16,616.4**
Payables	1,158.4	1,444.0	1,459.4	1,478.2	1,484.3
Interest bearing debt	4,312.0	3,109.0	3,164.0	3,514.0	3,514.0
Other liabilities	2,135.1	1,473.8	1,593.4	1,698.6	1,820.4
Total liabilities	**7,605.5**	**6,026.8**	**6,216.8**	**6,690.9**	**6,818.7**
Net assets	**7,132.9**	**7,339.0**	**7,678.6**	**9,274.8**	**9,797.8**
Ordinary equity	7,132.9	7,339.0	7,678.6	9,274.8	9,797.8
Minority interests	0.0	0.0	0.0	0.0	0.0
Preferred capital	0.0	0.0	0.0	0.0	0.0
Total shareholder funds	**7,132.9**	**7,339.0**	**7,678.6**	**9,274.8**	**9,797.8**
Net debt	**2,499.1**	**2,828.0**	**2,690.6**	**2,712.4**	**2,043.5**

Cashflow	06/12A	06/13A	06/14E	06/15E	06/16E
EBIT	730.4	1,049.3	1,004.2	1,146.1	1,319.4
Net interest	-98.0	-214.2	-186.5	-186.1	-201.2
Depr & Amort	173.9	287.1	339.9	411.4	425.6
Tax paid	-180.8	-71.1	-110.2	-165.6	-194.7
Working capital	-185.7	-473.8	-21.8	-47.2	-39.4
Other	26.7	24.5	0.0	0.0	0.0
Operating cashflow	**466.5**	**601.8**	**1,025.5**	**1,158.6**	**1,309.8**
Capex	-760.4	-570.4	-543.0	-2,119.3	-415.4
Capex - expansionary	-660.5	-387.4	-234.5	-1,809.2	-98.3
Capex - maintenance	-99.9	-183.0	-308.5	-310.1	-317.1
Acquisitions & Invest	143.2	4.2	-103.0	0.0	0.0
Asset sale proceeds	217.5	-33.1	0.0	0.0	0.0
Other	-131.6	49.8	-21.6	2.6	22.6
Investing cashflow	**-531.3**	**-549.5**	**-667.6**	**-2,116.7**	**-392.8**
Dividends paid	-185.8	-213.9	-346.8	-362.9	-390.2
Equity raised	879.4	-6.1	126.3	1,299.1	142.1
Net borrowings	431.0	-1,258.9	55.0	350.0	0.0
Other	0.0	-105.2	0.0	0.0	0.0
Financing cashflow	**1,124.6**	**-1,584.1**	**-165.5**	**1,286.3**	**-248.1**
Total cashflow	**1,059.8**	**-1,531.8**	**192.3**	**328.2**	**668.9**
Adjustments	0.0	0.0	0.0	0.0	0.0
Net change in cash	1,059.8	-1,531.8	192.3	328.2	668.9

Earnings		06/12A	06/13A	06/14E	06/15E	06/16E
Equiv. FPO (period avg.)	*mn*	*482.3*	*550.5*	*558.3*	*613.0*	*668.1*
EPS (Normalised)	c	99.9	108.7	100.3	107.7	115.4
EPS Growth	%		8.8	-7.7	7.3	7.2
EBITDA Margin	%	12.1	13.8	13.7	15.4	16.9
DPS	c	61.0	63.0	65.0	66.6	68.3
Payout	%	61.0	58.0	64.8	61.9	59.2
Franking	%	100.0	100.0	100.0	100.0	100.0
Free CFPS	c	76.0	76.1	128.4	138.4	148.6
Effective tax rate	%	29.0	29.1	29.1	29.1	29.1
Valuation						
P/E	x	14.7	13.5	14.6	13.6	12.7
PEG	x	2.5	1.5	-1.9	1.9	1.8
EV/EBIT	x	14.7	10.5	10.9	9.5	7.8
EV/EBITDA	x	11.8	8.3	8.1	7.0	5.9
Dividend Yield	%	4.2	4.3	4.4	4.5	4.7
FCF Yield	%	5.2	5.2	8.8	9.4	10.1
Price to Book	x	1.1	1.1	1.1	1.0	1.0
Returns						
Return on Equity	%	6.8	8.2	7.3	7.1	7.9
Profit Margin	%	6.5	6.2	5.7	6.5	7.4
Asset Turnover	x	0.5	0.7	0.7	0.6	0.6
Equity Multiplier	x	2.1	1.8	1.8	1.7	1.7
Return on Assets	%	3.3	4.5	4.0	4.1	4.6
Return on Invested Cap.	%	5.4	7.3	6.9	6.8	7.9
Gearing						
Net Debt to Net debt + Equity	%	25.9	27.8	25.9	22.6	17.3
Net Debt to EBITDA	x	2.8	2.1	2.0	1.7	1.2
Int Cover (EBITDA/Net Int.)	x	17.7	6.5	6.3	7.2	7.5
Int Cover (EBIT/Net Int.)	x	14.3	5.1	4.7	5.3	5.7
Capex to Sales	%	10.2	5.9	5.5	20.9	4.0
Capex to Depreciation	%	437.3	198.7	159.8	515.1	97.6

MSCI IVA (ESG) Rating BBB



Credit Suisse View

TP ESG Risk (%): -2.9

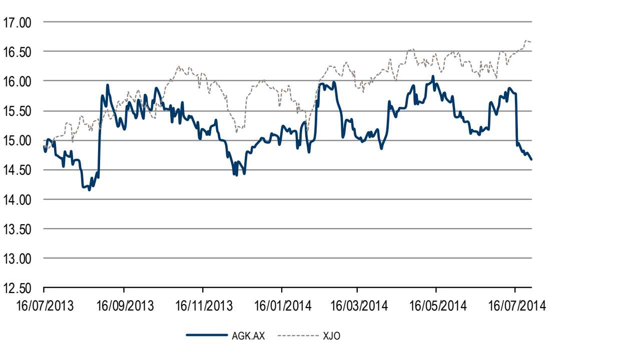
TP Risk Comment: We have excluded upside from Gloucester CSG and included the impact of lowering the carbon price to $12/t in our target price due to expectec changes in carbon tax legislation.

MSCI IVA Risk: Neutral

MSCI IVA Risk Comment: As expected, MSCI has downgraded its IVA rating for AGK from A to BBB due to LYA emissions. We now agree with MSCI's IVA rating and have a Neutral rating outlook.

Source: MSCI ESG Research

Share Price Performance



	1 Month	3 Month	12 Month
Absolute	-6.2%	-6.0%	-0.5%
Relative	-8.6%	-7.7%	-11.1%

Source: Reuters 52 week trading range: 14.15-16.08

Source: Company data, Credit Suisse estimates

Clarification of Rules Positive for AGK

- **The NSW government has announced plans to modify State planning policy which would allow AGK to hydraulic fracture without the completion of a full environmental impact study (EIS).**
- **Current rules:** Under the current NSW State Environmental Planning Policy (SEPP), proposals to drill or operate more than five wells within 3km of existing wells are deemed to be "State Significant Developments" which require a full environmental impact statement (EIS) in order to proceed.
- **The change:** Under the planned changes, the 3km rule will begin at the geometric centre of the proposed wells, not the nearest, to existing wells.
- **What does this mean for AGK?** The proposed amendments will remove the ambiguity surrounding whether AGK is required to produce an EIS or not. Its Waukivory Pilot Project consists of four wells, some of which are within 2-3kms of existing wells, though we understand the geometric centre of the proposed wells is not within 3km of an existing well. This would remove a potential hurdle that we have cited previously that would result in delays.
- **Other hurdles remain:** We continue to view the high level of resistance in the Gloucester Valley and surrounds will be an ongoing risk for AGK if it commences the Waukivory Pilot CSG Project. As a guide, almost all of the submissions to the NSW Department of Planning & Environment for the proposed amendments referenced AGK's Gloucester CSG project and were highly critical. Many opponents have called for an EIS as it provides a formal opportunity for public submissions and is a more transparent process. Avoiding this requirement may lead to the *perception* of a weakening of the approvals process, in our view.
- **Impact on land values still an issue:** According to a report commissioned by the NSW Government's Valuer General, there is not enough evidence to draw a conclusion on the impact of CSG's presence on land values in NSW. We believe this is the key concern among many that oppose CSG in the Gloucester Valley. If AGK believes this is the case, we think it could significantly reduce local opposition by guaranteeing land values, in our view. Otherwise, in light of the absence of evidence convincing local residents otherwise, we think concerns over potential impacts on land values will continue to drive opposition to AGK as those affected do not stand to benefit financially from CSG, unlike other land owners elsewhere in NSW and QLD.
- **AGK retail arm exposed:** A coordinated campaign targeting AGK's electricity and gas customers could result in customer loss and costs to AGK. Our sum-of-the-parts valuation values each customer at $1,466.
- **We reiterate** 2.9% downside included in AGK valuation from ESG issues over Gloucester development: AGK is targeting a 1H 2015 FID decision on this project and we believe there is a risk of delay or a 'no go ahead' decision. We have included only $88mn in value for exploration potential at Gloucester out of the $347.5mn book value (i.e. ~$260mn downside). This is also equivalent to a loss of ~180,000 customers. Our DCF valuation of a development at Gloucester is similar to the AGK book value.
- **Background:** We have written several notes on AGK's Gloucester CSG project. An overview of the project and key ESG issues can be found here. An update on AGK's approach to managing these risks can be found here.

Companies Mentioned *(Price as of 28-Jul-2014)*

AGL Energy (AGK.AX, A$14.67, NEUTRAL, TP A$15.6)

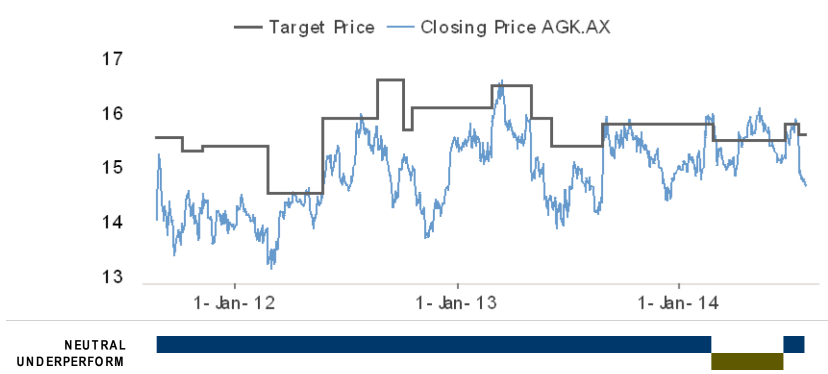
Disclosure Appendix

Important Global Disclosures

Sandra McCullagh and Peter Wilson, each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for AGL Energy (AGK.AX)

AGK.AX Date	Closing Price (A$)	Target Price (A$)	Rating
25-Aug-11	14.04	15.55	N
06-Oct-11	13.97	15.30	
08-Nov-11	14.20	15.39	
24-Feb-12	13.23	14.52	
24-May-12	14.45	15.90	
03-Jul-12	14.68		*
13-Jul-12	15.00	15.90	N
22-Aug-12	15.69	16.60	
04-Oct-12	15.10	15.70	
19-Oct-12	15.02	16.10	
27-Feb-13	15.87	16.50	
02-May-13	15.10	15.90	
05-Jun-13	14.36	15.40	
09-Jul-13	14.75	15.40	*
28-Aug-13	15.08	15.80	
26-Feb-14	15.95	15.50	U
25-Jun-14	15.18	15.80	N *
17-Jul-14	14.91	15.60	



** Asterisk signifies initiation or assumption of coverage.*

The analyst(s) responsible for preparing this research report received Compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark*over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, 12-month rolling yield is incorporated in the absolute total return calculation and a 15% and a 7.5% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively. The 15% and 7.5% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively. Prior to 10th December 2012, Japanese ratings were based on a stock's total return relative to the average total return of the relevant country or regional benchmark.*

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Overweight : The analyst's expectation for the sector's fundamentals and/or valuation is favorable over the next 12 months.

Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.

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**An analyst's coverage sector consists of all companies covered by the analyst within the relevant sector. An analyst may cover multiple sectors.*

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Global Ratings Distribution

Rating	Versus universe (%)	Of which banking clients (%)
Outperform/Buy*	44%	(53% banking clients)
Neutral/Hold*	40%	(50% banking clients)
Underperform/Sell*	13%	(48% banking clients)
Restricted	3%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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Price Target: (12 months) for AGL Energy (AGK.AX)

Method: We have a DCF based valuation (unrisked) of $16.38 and a 12-month target price of $15.60. Our DCF employs a weighted average cost of capital (WACC) of 9.31%. In setting our target price, we remove upside potential from AGK's upstream gas assets as we don't expect the market to pay for these assets given the difficulties in monetising these assets.

Risk: The risks to our A$15.60 target price on AGL Energy include: loss of retail customer market share, wholesale electricity costs, lower cost savings, lower returns on generation assets, and failure to realise wind farm development fees.

Please refer to the firm's disclosure website at https://rave.credit-suisse.com/disclosures for the definitions of abbreviations typically used in the target price method and risk sections.

See the Companies Mentioned section for full company names

Credit Suisse has a material conflict of interest with the subject company (AGK.AX) . Peter Wilson has approx. A$1,000 worth of AGL shares as part of an employee share purchase plan. They won't become unrestricted for 3 years.

Important Regional Disclosures

Singapore recipients should contact Credit Suisse AG, Singapore Branch for any matters arising from this research report.

The analyst(s) involved in the preparation of this report have not visited the material operations of the subject company (AGK.AX) within the past 12 months

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