

Australian Power and Gas Company

1H09 Result: On track for 100,000 customers by FY09

Event

1H09 revenue was \$31.5M and was driven by a further 14,000 customers acquired. Operating expenses before interest, tax, depreciation and amortisation for the year totaled \$7.7M and represented 24% of revenue. EBITDA was a loss of \$2.6M and reflects the continuing development phase of APK. Finance costs of \$2.5M were up on the pcp due to higher interest rates and a greater utilisation of debt facilities in the growth of the group's business. This was materially above our forecasts; however, this reflects the way we treat the company's convertible notes. A net loss after tax of \$5.647M was recorded, which is an improvement on the previous period's result of a loss of \$7.9M. No dividend was declared.

Implications

This is a strong revenue result from the company and most important, it is delivering on its customer acquisition targets. APK still faces a number of hurdles, but it has climbed many over the past 18 months and the business is slowly de-risking. Our FY09 revenue forecast is \$71.2M and we forecast a full-year EBITDA loss of \$0.9M (2H09: +\$1.8M). However, after that point and with 100,000 customers, we feel the company will be in a position to post a positive profit in 1H10 and to post positive operating cashflow in FY10. In economic times that continue to test consumers, we believe APK's product offering provides it with resilience, offering products that save people money and it has a cost base that is largely variable. Its relationship with its major shareholder and its ability to source funding in a constrained environment are also important characteristics. Signing 100,000 customers by 30 June 2009 and maintaining its churn rate in line with industry averages will be important sign posts moving into the FY09 result. Our valuation of APK is unchanged at \$0.34.

Investment Opinion

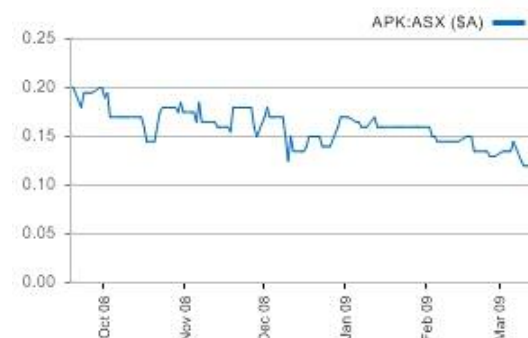
The research on this company has been commissioned and as such Aegis has received a fee for its initiation and ongoing research coverage.

No part of either the fee received by Aegis or the compensation paid to its analysts involved in preparing this report was, is or will be directly or indirectly, related to the valuation, earnings forecast or views expressed in this report.

Key Information

Share Price	\$0.12
Valuation	\$0.34

Price Performance



Market Statistics

Market Cap (M)	\$13
Shares (M)	110.8
% of All Ords	0.00
% of Sector	0.09
12 Month Range	\$0.12 - \$0.24
Company Risk	★☆☆☆☆
Share Price Risk	★☆☆☆☆
Ethical rating	★☆☆☆☆

	Performance against indices (%)		
	3 Months	6 Months	12 Months
APK	(11.1)	(42.9)	(48.9)
Sector	(9.6)	(23.2)	(28.4)
Market	(6.2)	(30.9)	(36.3)

Key Assumptions

Beta:	2.2
Market risk premium (%):	6.0
Risk free rate (%):	6.3
WACC (%):	17.1
Forecast cashflow (years):	10
Residual value % of total valuation:	37.6
Nominal terminal growth rate (%):	3.0

Earnings Summary

Yr to Jun	NPAT Rep \$M	NPAT ¹ Adj \$M	EPS ¹ c	EPS chg %	PER x	PER rel All Ords x	PER rel Sector x	DPS c	Yield %	Franking %	ROE %
2008A	(13.0)	(13.0)	(11.8)	n/a	(1.0)	(0.1)	(0.1)	0.0	0.0	0	(26.4)
2009F	(6.3)	(6.3)	(5.7)	n/a	(2.1)	(0.2)	(0.2)	0.0	0.0	0	(16.1)
2010F	2.1	2.1	1.9	n/a	6.4	0.7	0.7	0.0	0.0	0	5.6
2011F	12.5	12.5	11.3	499.2	1.1	0.1	0.1	0.0	0.0	0	28.1

¹ NPAT and EPS are adjusted by removing non-recurring items. All the above statistics are derived from normalised earnings.

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Valuation: \$0.34

Company risk ¹: ★★★★★

Share Price risk ¹: ★★★★★

Ethical rating ²: ★★★★★

Year end Jun. All figures in A\$M

Profit & loss summary					Ratio analysis				
	2008A	2009F	2010F	2011F		2008A	2009F	2010F	2011F
Operating revenue	34.5	70.9	128.3	156.2	Revenue growth (%)	>1000	105.6	80.9	21.8
Invest & other income	1.6	5.8	5.8	5.8	EBITDA growth (%)	n/a	n/a	n/a	165.2
EBITDA	(9.2)	(0.9)	8.8	23.3	EPS growth (%)	n/a	n/a	n/a	499.2
Depreciation/Amort	(5.3)	(4.8)	(3.5)	(3.5)	EBITDA/Sales margin (%)	(26.6)	(1.2)	6.8	14.9
EBIT	(14.5)	(5.6)	5.3	19.8	EBIT/Sales margin (%)	(42.0)	(7.9)	4.2	12.7
Net Interest	(3.3)	(3.4)	(2.5)	(1.9)	Tax rate (%)	27.0	29.9	26.2	30.0
Pre-tax profit	(17.8)	(9.1)	2.8	17.9	Net debt/equity (%)	30.0	57.1	51.0	14.1
Tax expense	4.8	2.7	(0.7)	(5.4)	Net debt/net debt + equity (%)	23.1	36.3	33.8	12.3
Minorities/Assoc./Prefs	0.0	0.0	0.0	0.0	Net interest cover (x)	(4.4)	(1.6)	2.1	10.2
NPAT	(13.0)	(6.3)	2.1	12.5	Payout ratio (%)	0.0	0.0	0.0	0.0
Non recurring items	0.0	0.0	0.0	0.0	Capex to deprec'n (%)	48.8	0.0	0.0	0.0
Reported profit	(13.0)	(6.3)	2.1	12.5	NTA per share (\$)	0.14	(0.01)	(0.02)	0.14
NPAT add Goodwill & Pref	0.0	0.0	0.0	0.0	ROA (%)	(20.0)	(7.5)	6.0	19.9
Adjusted profit	(13.0)	(6.3)	2.1	12.5	ROE (%)	(26.4)	(16.1)	5.6	28.1
Cashflow summary					Multiple analysis				
	2008A	2009F	2010F	2011F		2008A	2009F	2010F	2011F
EBITDA	(9.2)	(0.9)	8.8	23.3	Market cap (M)	13			
Working capital changes	7.1	0.5	0.9	0.0	Net debt (\$M)	30.7			
Interest and tax	(0.8)	(2.1)	(2.7)	(4.8)	Peripheral assets (\$M)	(0.0)			
Other operating items	(17.4)	(4.8)	(5.6)	(5.7)	Enterprise value (\$M)	44.0			
Operating cashflow	(20.4)	(7.3)	1.4	12.8	EV/EBIT (x)	(3.0)	(7.8)	8.3	2.2
Required capex	(0.0)	(0.0)	(0.1)	(0.2)	EV/EBITDA (x)	(4.8)	(50.9)	5.0	1.9
Maintainable cashflow	(20.4)	(7.3)	1.2	12.6	EV/EBITDA All Ind (x)	5.8	5.6	5.3	5.0
Dividends	0.0	0.0	0.0	0.0	EV/EBITDA rel All Ind (x)	(0.8)	(9.1)	0.9	0.4
Acq/Disp	0.1	0.2	0.0	0.0	P/E (x)	(1.0)	(2.1)	6.4	1.1
Other investing items	(0.9)	0.0	0.0	0.0	P/E rel All Ind (x)	(0.1)	(0.2)	0.7	0.1
Free cashflow	(21.3)	(7.1)	1.2	12.6	P/E rel All Ind ex banks (x)	(0.1)	(0.2)	0.6	0.1
Equity	3.5	0.0	0.0	0.0	P/E sector (x)	15.7	11.9	8.6	7.6
Debt inc/(red'n)	12.9	6.8	(1.2)	(12.6)	P/E rel sector (x)	(0.1)	(0.2)	0.7	0.1
Balance sheet					Assumptions				
	2008A	2009F	2010F	2011F		2008A	2009F	2010F	2011F
Cash & deposits	3.1	2.0	0.0	0.0	GDP growth (%)	3.58	2.10	2.35	2.88
Inventories	0.0	0.0	0.0	0.0	Interest Rates (%)	7.38	6.75	6.50	6.50
Trade debtors	14.3	22.2	35.0	41.4	Inflation (%)	3.40	4.20	3.30	2.75
Other curr assets	12.2	7.2	7.2	7.2					
Total current assets	29.6	31.4	42.1	48.6					
Prop., plant & equip.	0.1	0.1	0.1	0.1					
Non-curr intangibles	36.3	37.7	40.0	42.3					
Non-curr investments	3.8	3.0	3.0	3.0					
Other non-curr assets	5.6	9.4	9.4	9.4					
Total assets	75.4	81.6	94.6	103.4					
Trade creditors	10.1	18.3	32.0	38.4					
Curr borrowings	4.9	4.9	4.9	4.9					
Other curr liabilities	0.5	0.6	1.3	3.8					
Total current liab.	15.5	23.8	38.1	47.1					
Borrowings	11.9	18.2	14.9	2.3					
Other non-curr liabilities	2.8	2.7	2.7	2.7					
Total liabilities	30.1	44.7	55.8	52.1					
Minorities/Convertibles	0.0	0.0	0.0	0.0					
Shareholders equity	45.5	36.9	38.9	51.2					

Notes:1. The risk ratings are on a 12 month perspective, where five stars denotes low risk and one star denotes high risk. Company risk takes into account expected financial, strategic and execution risks associated with the company. Share price risk is a measure of the expected volatility of the price and other trading factors.

2. The Ethical rating rates a company on an ethical investment basis where five stars denote very good and one star a poor rating. The score is based on four key factors: areas of operating, environmental, corporate governance and social factors. For more information see www.aegis.com.au.

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TABLE 1: 1H09 RESULT SUMMARY

For the 6 months ended:**		pcp Dec-07	pp Jun-08	Aegis Dec-08	Actual Dec-08	Change pcp
Sales revenue	:\$M	12.0	22.5	39.3	31.5	+162%
EBITDA	:\$M	-5.0	-4.1	0.7	-2.6	-48%
Depreciation & amort	:\$M	-2.2	-3.1	-1.7	-3.0	+37%
EBIT	:\$M	-7.3	-7.2	-1.1	-5.7	-22%
Net Int Expense	:\$M	-1.8	-1.5	-0.8	-2.5	+35%
Profit Before Tax	:\$M	-9.1	-8.7	-1.9	-8.1	-11%
Tax on Recurring	:\$M	1.2	3.6	0.5	2.5	+103%
Profit After Tax	:\$M	-7.9	-5.1	-1.4	-5.6	-28%
Minorities/Associates	:\$M	0.0	0.0	0.0	0.0	
Preference Dividends	:\$M	0.0	0.0	0.0	0.0	
NPAT	:\$M	-7.9	-5.1	-1.4	-5.6	-28%
Non Recurring (net of Tax)	:\$M	0.0	0.0	0.0	0.0	
Reported Profit	:\$M	-7.9	-5.1	-1.4	-5.6	-28%
** All numbers are adj. for non-recurring items except Reported Profit						
PER SHARE DATA		Dec-07	Jun-08	Dec-08	Dec-08	
Average weighted Capital, fully diluted	:M	110	110	115	115	+5%
E.P.S. on Adj profit	:cents	-7.2	-4.7	-1.2	-4.9	-32%
D.P.S.	:cents	0.0	0.0	0.0	0.0	
Franking	:%	0	0	0	0	
Payout Ratio		0%	0%	0%	0%	+0%
Ratios		Dec-07	Jun-08	Dec-08	Dec-08	
EBITDA Margin	:%	-42.0	-18.4	1.7	-8.3	+34%
EBIT Margin	:%	-60.5	-32.2	-2.7	-18.0	+43%
Effective Tax rate	:%	13.4	41.1	25.0	30.4	+17%

Source: APK / Aegis Equities

Result Highlights

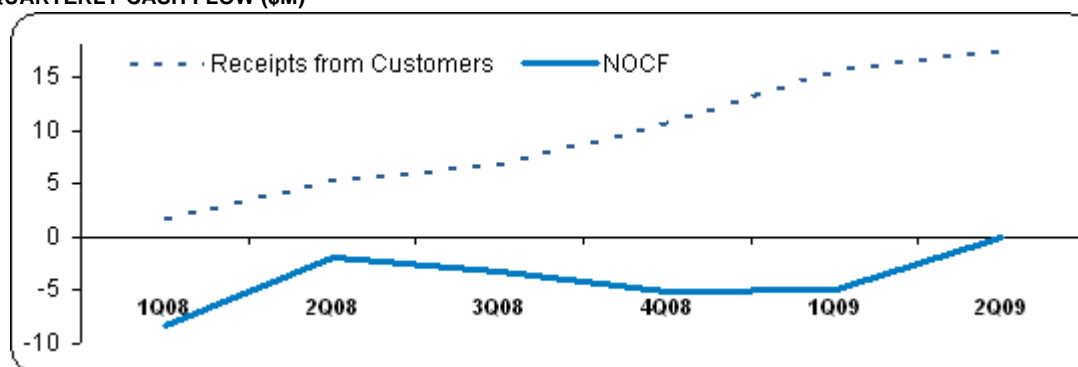
- **1H09 revenue** was \$31.5M and was driven by a further 14,000 customers acquired, bringing total customers at 31 December 2008 to 68,000. This was short of our expectations; however, our customer acquisition forecast was in line with the result. As a consequence, there must have been a delay in transferring acquired customers, thereby delaying revenue. The company advised this was the case and that it has rectified the situation.
- **Cost of sales** was \$26.5M and resulted in a gross margin of 15.8%.
- **Operating expenses** before interest, tax, depreciation and amortisation for the year totalled \$7.7M and represented 24% of revenue.
- **EBITDA** was a loss of \$2.6M and reflects the continuing development phase of APK.
- Our EBITDA forecast was beneath the result due to the factors discussed above in the revenue result. We note the company amortises most of its customer acquisition costs. In our model, we reflect this cash outgoing in our cashflow forecasts and have a non-cash offset in our Profit & Loss forecast, which understates amortisation. This has no overall affect on our valuation; however, our model works better presented this way.
- **Finance costs** of \$2.5M were up on the pcp due to higher interest rates and a greater utilisation of debt facilities in the growth of the group's business. This was materially above our forecasts, but reflects the way we treat the company's convertible notes.
- **A net loss after tax** of \$5.674M was recorded, which is an improvement on the previous period's result of a loss of \$7.9M.
- **Outlook** - APK did not provide any specific earnings guidance. However, at its AGM in November, APK's guidance was 100,000 billable accounts by 30 June 2009 and revenues of \$78M and \$134M and EBITDA of \$1.4M and \$12.7M for FY09 and FY10, respectively. We see no reason, given the current momentum, why the company cannot hit its customer acquisition target; however, due to the events discussed in 1H09 revenue above, we feel the company is unlikely to hit its FY09 revenue and EBITDA guidance given in November.

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Cashflow

- APK had cash and cash equivalents at 31 December 2008 of \$5.4M (FY08: \$5.9M). The cash balance includes amounts held as security for guarantees issued to suppliers of \$2.6M (FY08: \$2.8M). APK targets a minimum cash reserve to ensure there are sufficient funds on hand to address liquidity issues that may arise from wholesale market volatility as well as to meet debt-facility requirements.
- The cash shortfall from operations totaled \$4.8M, up from \$18.2M, which was funded via a combination of
 - convertible instrument issues of \$1.2M; and
 - drawdowns on debt facilities of \$4.5M (repayment of borrowings was \$1.5M).
- The cash shortfall for the half was expected; however, we note, importantly, that 2Q09 cashflow was positive. Given the seasonality effect coming into winter, we forecast negative operating cashflow in 3Q09 and 4Q09, which will lead to negative free cashflow in the full year. If customer acquisition tracks in line with our forecasts, APK should again generate positive operating cashflow in 2Q10 and *ceteris paribus*, we forecast APK to generate positive FY10 operating cashflow.
- In the meantime, APK will draw on an amount up to \$2.5M, which a significant shareholder has covenanted to provide either directly or in the form of an underwritten placement of APK's shares, subject to the shareholder's normal commercial terms and conditions. This would enable APK to meet its current forecast cash deficiency.
- APK's current forecasts indicate that in order to meet the current business plans, the ability to draw upon the currently available debt facility is required. In the event that sufficient cashflows from operations are not generated and/or the financial support of APK's financiers is not sufficient, the company will seek to implement alternative arrangements, including the raising of further funds. The ability of the company to find financial support was demonstrated in the half with the raising of \$3M via a convertible note issue and the continuing support of its major lender.

FIGURE 1: QUARTERLY CASH FLOW (\$M)



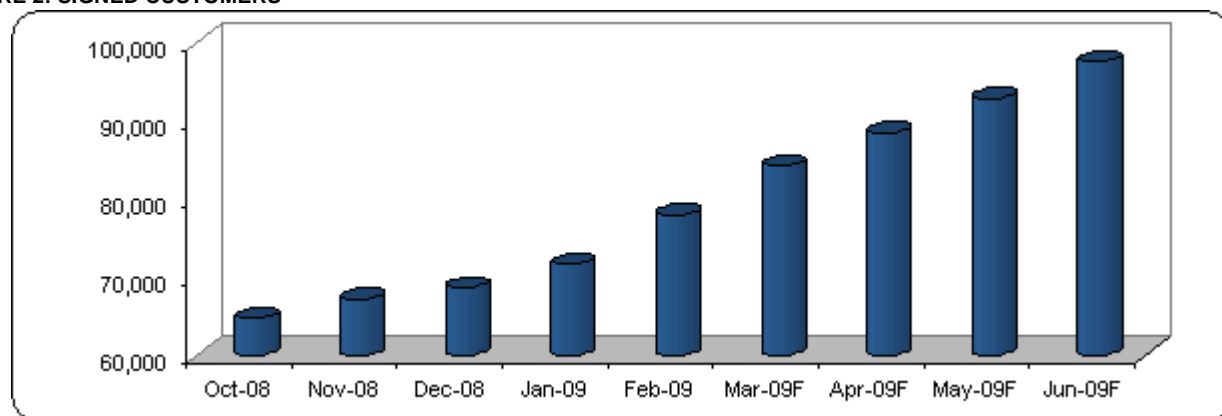
Source: APK / Aegis Equities

Other capital management

- During the half, APK drew down or repaid the following amounts under its debt facilities:
 - \$2.9M under a secured revolving term debt facility and an amount of \$334K was repaid. Interest is payable monthly at BBSW, plus a margin (not disclosed);
 - \$1.8M was repaid under a short-term loan provided by a director by the issue of 1,800 secured convertible notes, with a face value of \$1K each. Interest is payable annually at a rate of 8%. The secured notes are entitled to be converted into ordinary shares at an issue price of \$0.20 each or repaid on maturity, at the option of the noteholder. Maturity is two years from the date of issue; and
 - \$350K was advanced and \$500K repaid under loan agreement with a significant shareholder.
- During the half, APK issued 938,458 (1H08: 7,510,841) ordinary shares at \$0.18. As many as 827,358 were issued to repay debt and 111,100 in the form of a placement.
- During the half, the following options were issued:
 - **Employee share options** - 1,003,786 were issued at an exercise price of \$0.35 each and an expiry date of 1 October 2013.
 - **Director share options** - 2,142,857 were issued to directors with a fair value at grant date of \$0.10 each. The exercise price of the options is \$0.35 to \$0.70 and expiry date is 1 October 2013 to 30 October 2013.

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FIGURE 2: SIGNED CUSTOMERS



Source: APK / Aegis Equities - Note forecast periods are Aegis forecasts

Summary and Outlook

- This is a strong result from the company and most important, it is delivering on its customer acquisition targets. APK still faces a number of hurdles, but it has climbed many over the past 18 months and the business is slowly de-risking.
- APK did not provide any specific earnings guidance. However, at its AGM in November, APK's guidance was 100,000 billable accounts by 30 June 2009 and revenues of \$78M and \$134M and EBITDA of \$1.4M and \$12.7M for FY09 and FY10, respectively. We see no reason, given current momentum, why the company cannot hit its customer acquisition target; however, due to the events discussed in 1H09 revenue above, we feel the company is unlikely to hit its FY09 revenue and EBITDA guidance given in November.
- Our FY09 revenue forecast is \$71.2M and we forecast a full-year EBITDA loss of \$0.9M (2H09: +\$1.8M). However, after that point and with 100,000 customers, we feel the company will be in a position to post a positive profit in 1H10 and to post positive operating cashflow in FY10.
- In economic times that continue to test consumers, we believe APK's product offering provides it with resilience, offering products that save people money, and it has a cost base that is largely variable. Its relationship with its major shareholder and its ability to source funding in a constrained environment are also important characteristics. Signing 100,000 customers by 30 June 2009 and maintaining its churn rate in line with industry averages will be important sign posts moving into the FY09 result.
- Our valuation of APK is unchanged at \$0.34.



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