Contact Asset Management

INSIGHTS

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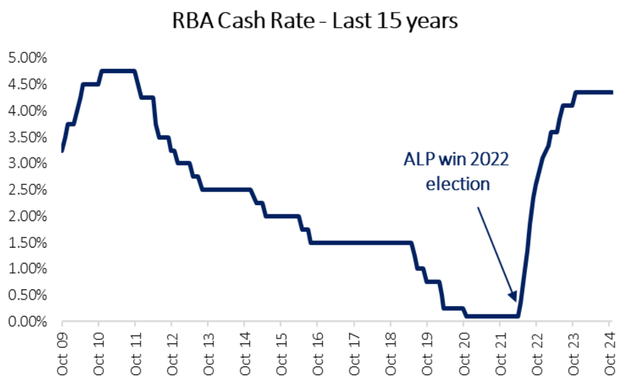
Shifting Political Landscape Impacts the Domestic Energy Sector

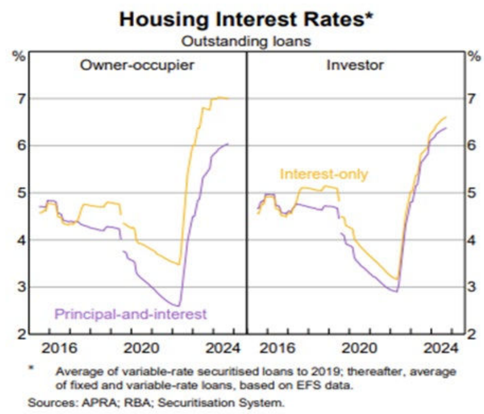
When Anthony Albanese was elected Prime Minister in 2022, he did so with a strong endorsement of promised climate change action. The recent Queensland election suggests that the voting public has become disillusioned with Labor's plans. The sentiment also extended to a swing against the Greens. A tighter economy, soaring power bills, distrust of renewable targets and cost of living pressures are taking a toll on Australian households. We are at a crossroads on Australian Energy Policy.

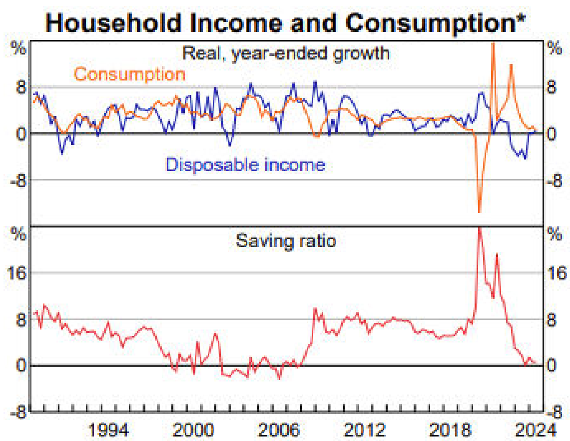
In this Contact Insights note, we consider where Energy Policy and Economics collide. We are bullish on Australian listed Energy companies and are overweight the sector. While we are advocates for sensible climate change outcomes, we see little commonsense in Australia's current policy settings. The recent power outage in Broken Hill is a stark reminder of what can go wrong. We expect the Australian Energy Transition to take far longer than originally planned which we believe will result in a better-than-expected outcome for many listed companies.

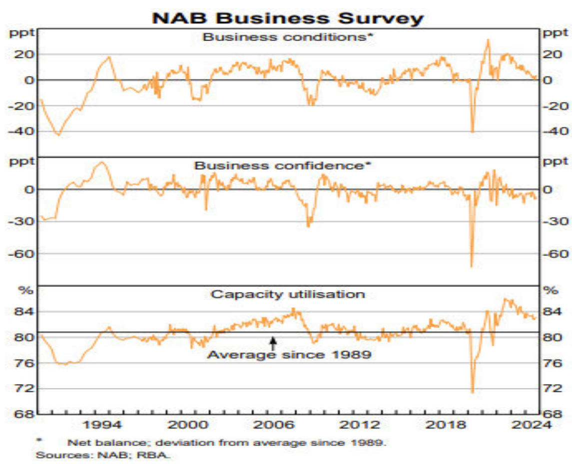
Cost-of-Living Concerns have outpaced support for Expensive Renewables

When Australia went to the polls on 21 May 2022 to elect Anthony Albanese and the Australian Labor Party, we had a radically different economic environment. After a period of artificially low interest rates, the RBA had just lifted the Cash Rate for the first time since November 2010 from 0.10% to 0.35%. Variable mortgage rates were sub 3% and many households were still living off the enormous Covid-induced handouts. Business conditions and confidence was recovering. Inflation was a challenge; however the employment market was robust and job ads were at buoyant levels.









Source: RBA, Contact Asset Management

The 2022 Australian Federal Election was fought less on economic issues where the Coalition is historically viewed as stronger. While the ALP promised to fight the impending cost of living crisis, significant voter attention focused on action on climate change as well as constitutional recognition for Aboriginal and Torres Strait Islander people. This was evidenced by the fact that support for the Greens rose substantially from 10.5% to 12.3%, the party gaining an extra 300,000 votes in the Lower House.

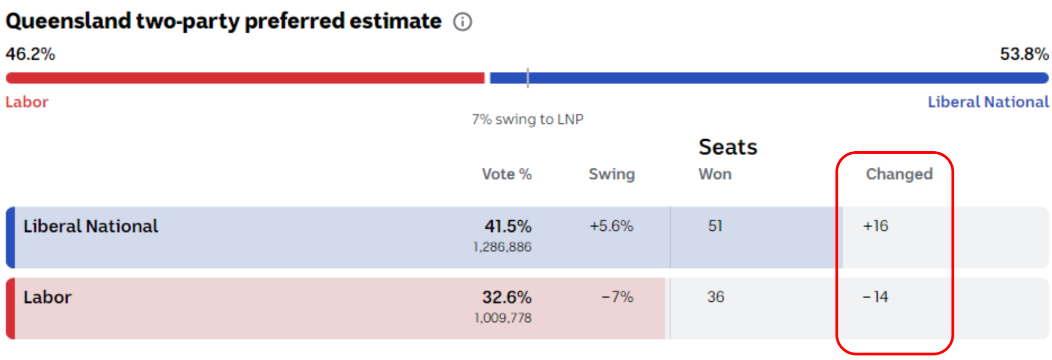
However, two years on and the state of the economy has seemingly returned to the forefront of voters minds. Many households are stretched and we are witnessing a two-speed economy whereby wealthy retirees are enjoying attractive returns on term deposits, share portfolios and property investments. Yet, many households are struggling under the weight of higher mortgage payments or rents, fuel prices, food inflation and drastically higher energy bills. The reduction in the Saving ratio (refer previous page) speaks volumes. Doug Jones, CEO of Metcash (MTS.ASX), said recently that there is no "average consumer" at the moment, noting the growing gap between the "haves" and "have-nots". During its August results briefing Coles' (COL.ASX) management mentioned the term "value" 27 times—up significantly from just three mentions in FY21.

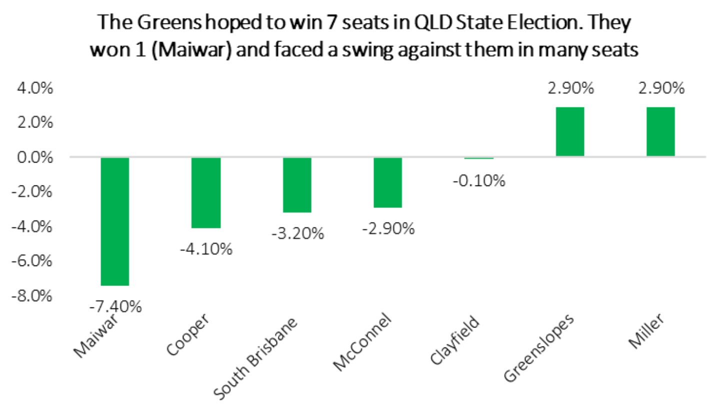
Jennie George, a former ACTU president and Labor MP for Throsby, criticised the Albanese Government in a recent article in The Australian[1]. Some of her observations included:

- The Albanese government is facing a loss of social licence for its energy transition, particularly in regional areas. A recent survey confirmed this decline, with less than half of the respondents (47%) feeling positive about the renewables transition compared with the peak of 70% in August 2022.
- Labor's message doesn't accord with the experiences of many communities or acknowledge the burden of rising power bills and systemic problems.
- To claim weather-dependent, intermittent renewables are reliable is akin to Bowen's claim that renewables are the cheapest form of energy because the sun and wind don't send you bills. People see through the spin, knowing the cost of power has never been higher.
- With Victoria, Bowen has repeatedly rejected gas, even as a transition fuel, and excluded it from the CIS. How does he intend to replace 90%of our baseload power with coal's exit during the next decade, without the use of gas?
- Labor's plans are not working well and its 2030 targets won't be met. We're at a crossroad where decisions about our energy future will have lasting consequences.

Ms George's concerns were echoed in the results of the Queensland election.

The Australian Public is Seemingly Frustrated with our Energy Policy (based on recent Queensland election)

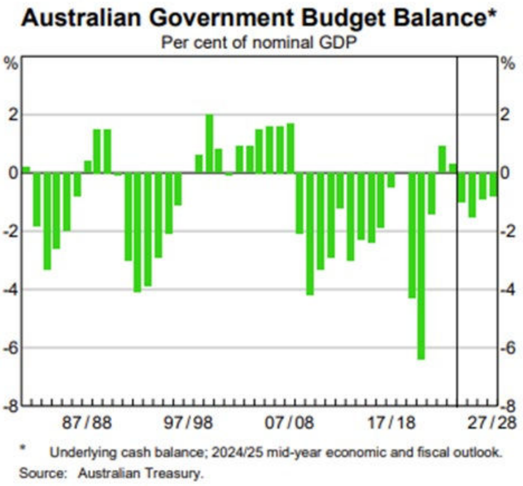


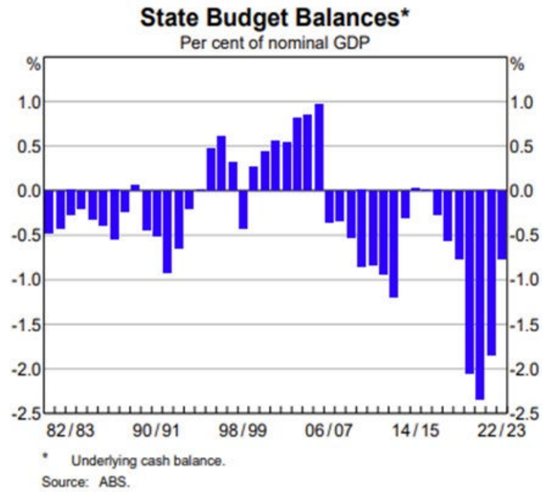


Source: ABC News. *Note this was prepared on 7 November and just under 90% of vote had been counted.*

[1] Jennie George "Bowen's Reliable Renewables plan is serving us ill" The Australian, 12 October 2024

An additional question on voters minds is how is Australia going to pay for all of this? Federal Minister Bowen announced the $22.7 billion *"A Future Made in Australia"* policy in November 2023, which is aimed at funding Australia's transition to net zero. In a nutshell, coal was coming out, renewables were moving in and taxpayers would underwrite the transformation. For what it's worth, the Government is striving to meet its 2030 target of 43% on 2005 levels, a target which requires renewables to comprise 82% of the energy mix by the end of the decade. They currently comprise 46%. As depicted in the following charts, Australia's Balance Sheet is hardly fortress like. Taxpayers will likely need to cough up.



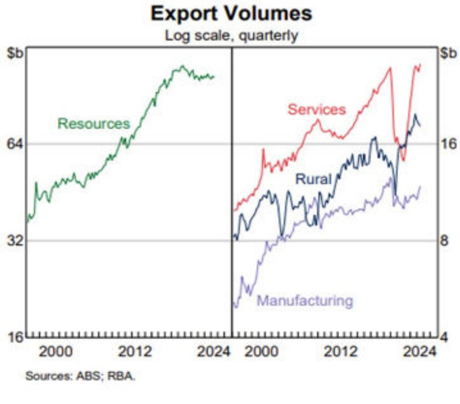


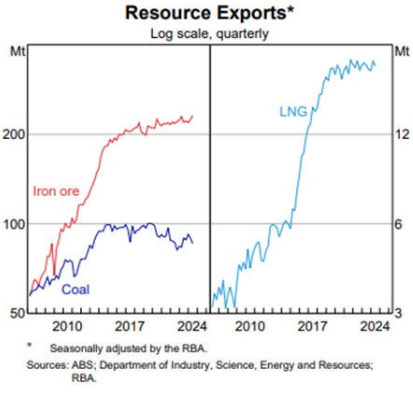
Which begs the question, why are we killing the Golden Goose? Australia's global competitive advantage lies not in our Services and Manufacturing industries. Wages are simply too high to compete against our South-East Asian peers. Our competitive advantage lies in our natural resources. The Export volumes chart from the RBA below is powerful albeit easily misinterpreted by the scale. Resources export is a near $100 billion industry for Australia, almost 10-fold the size of Manufacturing. Australia has the potential to be a meaningful player in exports while also ensuring that we lock-in our own supply while the Energy Transition plays out.

Global energy consumption is projected to surge by 50% by 2050, with Asia driving much of this growth. Since 2000, Southeast Asia's rapid industrialization and urbanization have already fuelled an 80% rise in energy demand. Consumers are increasingly shifting from fossil fuel-based transportation, heating, and cooking toward electric alternatives. Yet, without access to low-emission power sources, this transition risks merely relocating emissions rather than reducing them. Given these dynamics, demand for high-quality Australian coal is likely to remain strong for the foreseeable future.

If Australia is going to remain competitive globally, we believe that Government needs to secure supplies of energy at the cheapest price to power our economy. We risk losing our competitive edge to poor public policy. The first step is to find bipartisan support for gas. While we are optimistic on the growth of LNG exports in the coming decades, Australia must also protect domestic supply as a priority. In August, APA Limited cautioned that prioritizing LNG import terminals over investment in domestic gas supply could lead to a substantial increase in energy prices and emissions. The company projects that industrial gas prices along the East Coast might surge from current levels of $13-$15/GJ to approx. $24/GJ, a stark contrast to the historical prices of $4-$5/GJ .

With 90% of Australia's coal generation set to close over the next decade, the Albanese government faces a pressing challenge: replacing this lost capacity to prevent blackouts. While renewables will play a role in the energy mix, even firmed renewables struggle to provide the reliable baseload power essential to the grid. To ensure stability in a post-coal era, gas or nuclear options will need serious consideration. However, no matter the strategy, this transition is likely to take far longer than Minister Bowen anticipates.





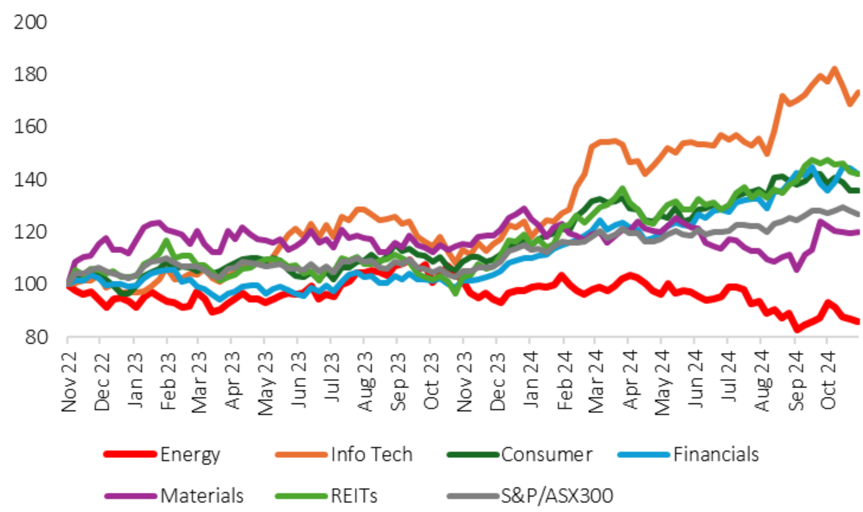
Our approach – we are overweight Energy on the basis that the Energy Transition is long-dated

We maintain a bullish outlook on the Australian energy sector, despite concerns over flawed public policies from the current Federal Government. Our position is rooted in the belief that energy demand will far exceed the supply response from renewables. The renewable energy supply chain faces significant challenges. Just when the world urgently needs new infrastructure, investment in solar and wind projects has slowed sharply. China, meanwhile, is absorbing the majority of available supply to meet its own needs, creating further strain at a time when global demand for renewables is surging.

Demand for energy is not slowing down. The demand for electricity from data centres in Australia is set to grow significantly over the next decade, driven by advancements in AI, cloud computing, and digital transformation. By 2030, data centres are expected to consume between 8% and potentially up to 15% of Australia's total electricity supply, a notable increase from around 5% in 2024[2]. It is difficult to see the transition to renewables offsetting this growth. Without substantial grid expansion or alternative energy sources, this projected increase could place significant strain on Australia's power infrastructure, particularly as coal plants are gradually phased out. Addressing this demand will likely require substantial investments in baseload energy supply and enhanced grid capacity to support the expanding digital economy in a sustainable manner

What does this mean for stocks? While we think our belief in the need for a near-term solution using fossil fuels (especially gas) is sensible, we don't think it is the consensus view. The following chart highlights that over the last two years the Energy sector has lagged the broader market by a sizable margin. With higher-than-expected demand for Energy, we expect that to mean-revert.

The Energy sector has lagged the market over the past two years



Source: FactSet, Contact Asset Management

How is Contact Asset Management investing in Energy?

Oil/Gas	APA Group, Woodside Energy
Coal	New Hope Group, Whitehaven Coal, Yancoal Australia, Aurizon Holdings, Dalrymple Bay Infrastructure
Fuel	Ampol Limited
Services	Service Stream
Data Centres	Goodman Group

[2] International Energy Agency (IEA)

Investing in Energy is not necessarily an anti-ESG approach

Contrary to many expectations, not all fossil fuel companies fail the ESG test. The following table highlights the MSCI ratings for many of the companies mentioned above.

MSCI ESG Ratings for Companies mentioned in this report

Company	MSCI ESG Rating	Company	MSCI ESG Rating
apa	AAA	WHITEHAVEN	A
Woodside Energy	AAA	YANCOAL AUSTRALIA	BBB
AMPOL	AA	ServiceStream	AAA
AURIZON	AAA	NHG NEW HOPE GROUP	BBB
Goodman	AA	Dalrymple Bay Infrastructure	N/A

Conclusion

The intersection of public opinion and energy policy in Australia has created a challenging environment for the Government as it tries to balance climate goals with economic needs. Recent election outcomes in Queensland, along with global trends, reflect growing public frustration with the pace of renewable energy efforts in the face of rising living costs and financial pressures. At this pivotal point, a careful rethinking of energy policies is needed to help control costs, restore public trust, and ensure a reliable energy supply for the future. While we remain cautiously optimistic about the potential of Australian energy companies to adapt, it's essential that future plans find the right balance between environmental goals and economic realities. This approach will support a more resilient energy system that serves both the public and the market.

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