

Refining NZ

Customer Costs Continue — July/August 2020

Operating Performance

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NEUTRAL

Refining NZ's (NZR) operating statistics for July/August 2020 show that processing fees before top-up payments were negative for the refinery, with the reported processing fee of NZ\$23.7m equivalent to the fee floor. The top-up payments from NZR's customers means it continues to operate cash neutral, although we estimate the effective top-up payment for this period was ~NZ\$31.5m due to the -US\$4.18/barrel July/August 2020 gross refining margin. NZR has indicated it expects the fee floor will be in operation for the remainder of the year, and as we await the outcome of the strategic review we maintain our NEUTRAL rating and make no changes to forecasts.

NZX Code	NZR	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$0.61	NPAT* (NZ\$m)	4.2	-54.3	-34.4	25.4	PE	45.8	n/a	n/a	7.5
Target price	NZ\$0.80	EPS* (NZc)	1.3	-67.8	-11.0	8.1	EV/EBIT	24.2	n/a	n/a	9.9
Risk rating	High	EPS growth* (%)	-85.9	n/a	83.8	n/a	EV/EBITDA	3.7	10.7	7.2	3.1
Issued shares	312.6m	DPS (NZc)	2.0	0.0	0.0	0.0	Price / NTA	0.3	0.4	0.4	0.4
Market cap	NZ\$191m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.3	0.0	0.0	0.0
Avg daily turnover	359.0k (NZ\$364k)	*Based on normalised profits					Gross div yld (%)	4.6	0.0	0.0	0.0

Grim throughput and refining margins, but NZR protected by the fee floor arrangements

As anticipated, NZR continued to operate at fee floor levels through July/August 2020, with a record low gross refining margin (GRM) of -US\$4.18/barrel. July/August 2020 is the first period where both the Singapore complex benchmark GRM and NZR's uplift have been negative at -US\$2.46/barrel and -US\$1.72/barrel respectively. Not helping the GRM was the six week shut down period (enabling customers to rebalance inventory), resulting in refinery throughput dropping to a record low 1.77m barrels, compared to 7.42m barrels during the same period last year. NZR's underlying processing fee was ~NZ\$7.8m (i.e. before the fee floor top payment).

NZR's top-up payments ensured its processing fee equalled the fee floor of NZ\$23.7m. NZR continues to operate on a cash neutral basis and keep debt stable at NZ\$249m.

No change to forecasts as focus remains on Strategic Review outcomes

NZR has indicated that it expects to operate at the fee floor for the remainder of the year, which is consistent with our assumption that it receives the NZ\$140m processing fee floor for FY20 and continues to run at a dialled-down mode in the near-term. The main focus for the refinery remains the outcome of its Strategic Review, with the first stage focussed on operating the refinery on a cash neutral basis expected to be announced to market in early October (a week or two later than expected). However, the second stage of the Strategic Review looking at the possible conversion of NZR to an import terminal is the key part of the review, and until then NZR remains in a holding pattern from an investor's perspective.

We make no changes to our forecasts, and there remains a wide range of possible value outcomes from the second stage of the Strategic Review.

Refining NZ (NZR)

Priced as at 21 Sep 2020 (NZ\$) **0.61**

12-month target price (NZ\$)*	0.80
Expected share price return	31.1%
Net dividend yield	0.0%
Estimated 12-month return	31.1%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.09
WACC	7.1%
Terminal growth	0.0%

Spot valuations (NZ\$)	
1. Scenario valuation	0.82
2. n/a	n/a
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	681
(Net debt)/cash	(256)
Less: Capitalised operating leases	
Value of equity	425

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	362	348	225	244	348
Normalised EBITDA	153	118	41	61	141
Depreciation and amortisation	(97)	(100)	(102)	(99)	(96)
Normalised EBIT	56	18	(61)	(37)	44
Net interest	(14)	(13)	(13)	(11)	(9)
Associate income	0	0	0	0	0
Tax	(12)	(1)	20	13	(10)
Minority interests	0	0	0	0	0
Normalised NPAT	30	4	(54)	(34)	25
Abnormals/other	0	0	(158)	0	0
Reported NPAT	30	4	(212)	(34)	25
Normalised EPS (cps)	9.5	1.3	(67.8)	(11.0)	8.1
DPS (cps)	7.5	2.0	0	0	0

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	2.6	3.7	10.7	7.2	3.1
EV/EBIT (x)	7.2	24.2	n/a	n/a	9.9
PE (x)	6.4	45.8	n/a	n/a	7.5
Price/NTA (x)	0.3	0.3	0.4	0.4	0.4
Free cash flow yield (%)	-30.3	20.7	-3.8	2.0	23.8
Net dividend yield (%)	12.3	3.3	0.0	0.0	0.0
Gross dividend yield (%)	17.1	4.6	0.0	0.0	0.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	4.0	1.4	n/a	n/a	4.9
Interest cover EBITDA (x)	11.1	8.8	3.2	5.8	15.6
Net debt/ND+E (%)	25.3	24.1	31.7	32.9	27.6
Net debt/EBITDA (x)	1.7	2.0	6.1	4.0	1.4

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	-12.6	-3.9	-35.3	8.2	42.8
EBITDA (%)	-30.7	-22.5	-65.4	50.1	>100
EBIT (%)	-55.3	-67.1	n/a	n/a	n/a
Normalised NPAT (%)	-62.3	-85.9	n/a	n/a	n/a
Normalised EPS (%)	-62.3	-85.9	n/a	n/a	n/a
Ordinary DPS (%)	-58.3	-73.3	-100.0	n/a	n/a

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	4.0	1.3	-5.6	-3.5	4.2
Return on equity (%)	3.9	0.5	-10.1	-6.9	4.8
Return on funds employed (%)	4.6	2.1	-4.8	-2.8	5.1
EBITDA margin (%)	42.1	33.9	18.2	25.2	40.3
EBIT margin (%)	15.3	5.3	-27.1	-15.3	12.7
Capex to sales (%)	44.8	22.3	16.3	26.6	21.6
Capex to depreciation (%)	167	78	36	66	78
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	79	150	0	0	0

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	153	118	41	61	141
Working capital change	(39)	23	(15)	4	(1)
Interest & tax paid	(25)	(19)	1	3	(19)
Other	16	(6)	2	0	0
Operating cash flow	105	117	30	69	121
Capital expenditure	(162)	(78)	(37)	(65)	(75)
(Acquisitions)/divestments	0	0	0	0	0
Other	0	0	0	0	0
Funding available/(required)	(58)	39	(7)	4	45
Dividends paid	(47)	(20)	0	0	0
Equity raised/(returned)	(0)	(0)	0	0	0
(Increase)/decrease in net debt	(105)	19	(7)	4	45

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue Breakdown (NZ\$m)					
Processing fee revenue	259	242	140	145	230
Natural gas recovery	32	40	24	28	41
Other refining revenue	14	16	15	16	16
Pipeline revenue	44	36	31	42	48
Other revenue	14	14	15	13	13
Total revenue	362	348	225	244	348

Processing fee drivers					
Refining margin (USD/barrel)	6.2	5.3	2.2	3.7	5.6
NZDUSD	0.69	0.66	0.25	0.50	0.68
Throughput (mbbls)	40.4	42.7	23.4	28.0	40.0
Refining margin (NZD/barrel)	6.2	5.7	2.6	3.8	5.8

Fee floor (estimated) (USD/barrel)	3.3	3.0	2.2	3.6	3.5
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Operating cost breakdown (NZ\$m)					
Process materials and utilities	49	59	45	48	55
Natural gas costs	32	40	24	28	41
Materials & contractor payments	29	31	19	18	22
Wages & salaries	61	61	62	56	57
Admin & other expenses	38	39	33	32	33
Total expenses	210	230	185	183	208

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

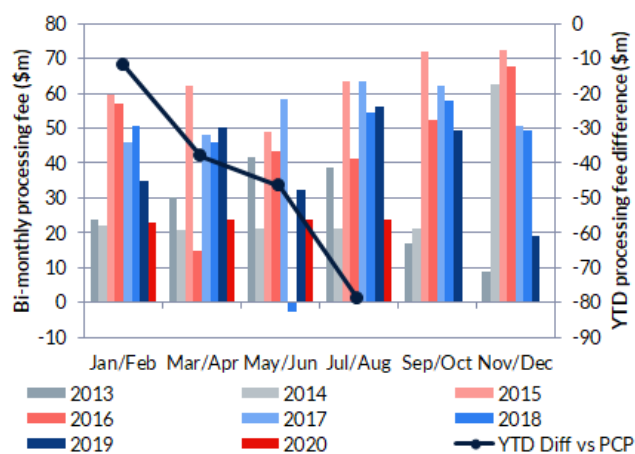
July/August 2020 operating performance

Figure 1. July/August 2020 operating statistics

	Jul/Aug 2019	May/ Jun 2020	Jul/Aug 2020	% Diff pcp	% Diff mom
Throughput (000 barrels)	7,419	3,867	1,766	-76%	-54%
Gross Refining Margin (US\$/barrel)	\$7.10	\$4.59	-\$4.18	n/a	n/a
NZDUSD	0.656	0.630	0.660	1%	5%
NZD processing revenue (NZ\$m)	56.2	23.3	23.7	-58%	2%
Fee floor payment (NZ\$m)	0.0	3.6	31.5		

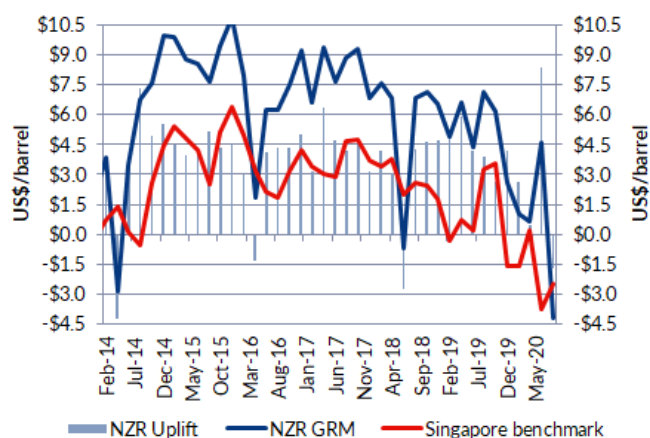
Source: NZR, Forsyth Barr analysis

Figure 2. Bi-monthly processing fee revenue



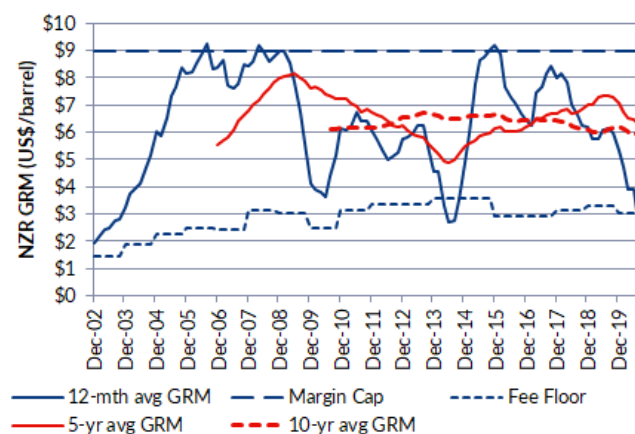
Source: NZR, Forsyth Barr analysis

Figure 3. Gross refining margin (GRM) vs. Singapore benchmark

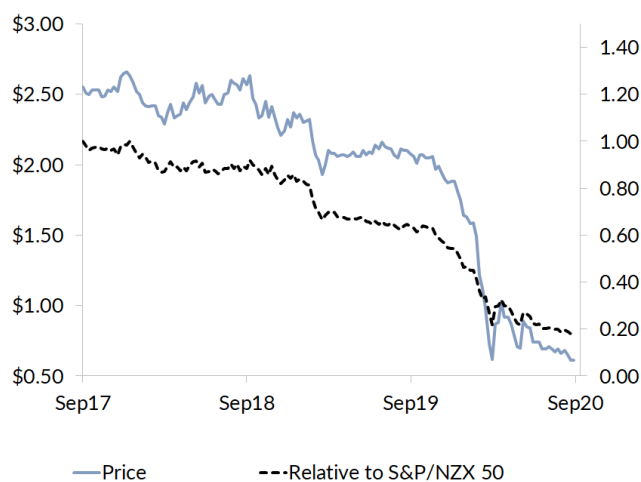


Source: NZR, Forsyth Barr analysis

Figure 4. Historic GRM (excludes fee floor effect)



Source: NZR, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Mobil Oil NZ Limited	17.2%
Z Energy Holdings Limited	15.4%
BP	10.1%
Wellington Management Company	9.3%
ACC	5.0%

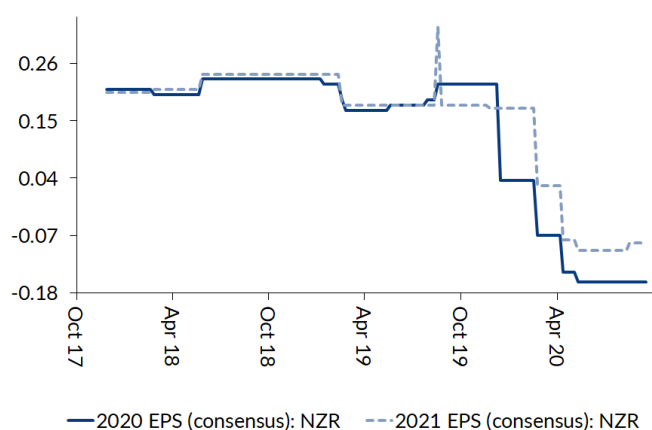
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

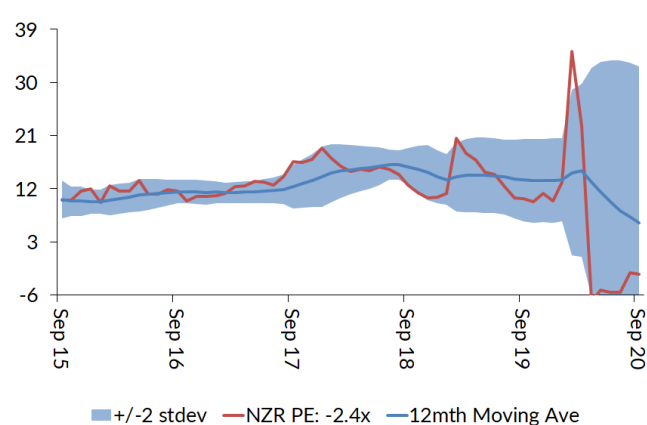
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect NZR's balance date - December)										
Refining NZ	NZR NZ	NZ\$0.61	NZ\$191	<0x	<0x	10.6x	7.0x	<0x	<0x	0.0%
FORMOSA PETROCHEMICAL CORP	6505 TT	TWD84.80	TWD807,801	>50x	21.8x	29.0x	13.3x	44.9x	16.8x	3.1%
IDEMITSU KOSAN CO	5019 JP	¥2426.00	¥722,620	4.4x	10.0x	11.9x	7.8x	<0x	23.8x	5.0%
SK INNOVATION CO	096770 KS	KRW158500.00	KRW14,655,792	<0x	26.9x	<0x	9.5x	<0x	21.9x	1.8%
S-OIL CORP	010950 KS	KRW54400.00	KRW6,124,504	<0x	9.4x	>75x	8.1x	<0x	12.4x	3.1%
Compco Average:				4.4x	17.0x	20.5x	9.7x	44.9x	18.7x	3.2%
NZR Relative:				n/a	n/a	-48%	-27%	n/a	n/a	-100%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (NZR) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

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