

Refining NZ

Cash Neutral to End of FY21

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NEUTRAL 

Refining NZ (NZR) has confirmed it will operate on a cash neutral basis (at worst), until at least the end of FY21. It will achieve this goal by reducing refinery operating capacity. However, critical to the value of NZR is the outcome of the terminal conversion discussions which remain ongoing. NZR provided no indication of when discussions will conclude. Given the wide range of possible value outcomes (some of which are lower than the current share price) we retain our NEUTRAL rating.

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	-45.8	-29.0	-10.2	PE	45.8	n/a	n/a	n/a
Target price	NZ\$0.80	EPS* (NZc)	1.3	-65.1	-9.3	-3.3	EV/EBIT	24.2	n/a	n/a	n/a
Risk rating	High	EPS growth* (%)	-85.9	n/a	85.7	64.9	EV/EBITDA	3.7	11.5	7.7	5.4
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	357.8k (NZ\$351k)	*Based on normalised profits					Gross div yld (%)	4.6	0.0	0.0	0.0

Cash neutral in 2021 – operating capacity reduces

NZR has successfully achieved its goal of being able to operate on a cash neutral basis in FY21. NZR is cutting operating capacity ~-22% to 90,000 barrels/day (~33m barrels/year in a non-outage year) by mothballing a small crude distillation unit. FY21 opex cost savings are expected to be ~-NZ\$20m vs. FY20 with savings coming from lower labour and "other" costs. There will however be ~NZ\$5m of restructuring costs (offset by surplus asset sales). FY21 capex is expected to be ~NZ\$50m (vs. ~NZ\$35m in FY20) due to deferred maintenance capex. The effect for customers of reducing refinery capacity is to lift the processing fee floor from ~US3.0/ barrel (when the refinery operates at full capacity) to ~US\$4.3/barrel in FY21 (i.e. the gross refining margin (GRM) needs to be above US\$4.3/barrel to make more than the fee floor). It also lifts the "break-even" point for customers – we estimate to above US\$6.0/ barrel, meaning the customers are incentivised to do a deal that results in NZR converting to an import terminal.

Terminal conversion discussions ongoing – timing uncertain

Discussions with customers on converting the refinery to an import terminal continue. Today's announcement places more pressure on NZR's customers (Z Energy, BP & Mobil) as it alleviates the short-term financial pressure on NZR and confirms its customers are likely to continue competing at a disadvantage to fuel retailers that source fuel based on import prices (due to the increase in the break-even GRM). The key focus of current discussions is the price to access import terminal facilities and the pipeline. Mobil's decision to file a notice of dispute under the Processing Agreement will likely delay final discussions.

Modest FY21 forecast changes, bigger FY22 changes, but NZR value still depends on terminal conversion discussions

We have lowered FY20/FY21/FY22 EBITDA forecasts -NZ\$3m/-NZ\$3m/-NZ\$58m to NZ\$38m/NZ\$58m/NZ\$83m respectively. Our forecasts assume NZR operates at the fee floor through FY21 and 1H22, and that processing volumes in FY21 and FY22 are consistent with NZR's new operating capacity.

We maintain our view that NZR will likely convert to an import terminal. The value outcomes for NZR remain wide and depend heavily on conversion costs (NZR is keeping that figure confidential given current negotiations) and import terminal & pipeline fees under an import model. Whilst we are gaining comfort that the downside is not negative, there remains a wide range of possible value outcomes (NZ\$0.25/share to NZ\$1.80/share).

Refining NZ (NZR)

Priced as at 05 Oct 2020 (NZ\$) **0.61**

12-month target price (NZ\$)*		0.80	Spot valuations (NZ\$)									
Expected share price return		31.1%	1. Scenario valuation	0.86								
Net dividend yield		0.0%	2. n/a	n/a								
Estimated 12-month return		31.1%	3. n/a	n/a								
Key WACC assumptions		DCF valuation summary (NZ\$m)										
Risk free rate	1.30%	Total firm value	647									
Equity beta	1.09	(Net debt)/cash	(256)									
WACC	7.1%	Less: Capitalised operating leases										
Terminal growth	0.0%	Value of equity	391									
Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E	
Sales revenue	362	348	227	237	257	EV/EBITDA (x)	2.6	3.7	11.5	7.7	5.4	
Normalised EBITDA	153	118	38	58	83	EV/EBIT (x)	7.2	24.2	n/a	n/a	n/a	
Depreciation and amortisation	(97)	(100)	(88)	(87)	(87)	PE (x)	6.4	45.8	n/a	n/a	n/a	
Normalised EBIT	56	18	(49)	(29)	(4)	Price/NTA (x)	0.3	0.3	0.4	0.4	0.4	
Net interest	(14)	(13)	(13)	(11)	(10)	Free cash flow yield (%)	-30.3	20.7	-8.9	-0.2	9.5	
Associate income	0	0	0	0	0	Net dividend yield (%)	12.3	3.3	0.0	0.0	0.0	
Tax	(12)	(1)	16	11	4	Gross dividend yield (%)	17.1	4.6	0.0	0.0	0.0	
Minority interests	0	0	0	0	0	Capital Structure		2018A	2019A	2020E	2021E	2022E
Normalised NPAT	30	4	(46)	(29)	(10)	Interest cover EBIT (x)	4.0	1.4	n/a	n/a	n/a	
Abnormals/other	0	0	(158)	0	0	Interest cover EBITDA (x)	11.1	8.8	3.0	5.4	8.1	
Reported NPAT	30	4	(203)	(29)	(10)	Net debt/ND+E (%)	25.3	24.1	32.0	33.2	32.1	
Normalised EPS (cps)	9.5	1.3	(65.1)	(9.3)	(3.3)	Net debt/EBITDA (x)	1.7	2.0	6.7	4.4	2.9	
DPS (cps)	7.5	2.0	0	0	0	Growth Rates		2018A	2019A	2020E	2021E	2022E
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Key Ratios	2018A	2019A	2020E	2021E	2022E	
EBITDA	153	118	38	58	83	Return on assets (%)	4.0	1.3	-4.5	-2.7	-0.4	
Working capital change	(39)	23	(12)	2	0	Return on equity (%)	3.9	0.5	-8.4	-5.6	-2.0	
Interest & tax paid	(25)	(19)	(8)	(11)	(10)	Return on funds employed (%)	4.6	2.1	-3.7	-2.0	0.4	
Other	16	(6)	2	0	0	EBITDA margin (%)	42.1	33.9	16.8	24.3	32.4	
Operating cash flow	105	117	20	49	73	EBIT margin (%)	15.3	5.3	-21.8	-12.4	-1.5	
Capital expenditure	(162)	(78)	(37)	(49)	(55)	Capex to sales (%)	44.8	22.3	16.2	20.8	21.4	
(Acquisitions)/divestments	0	0	0	0	0	Capex to depreciation (%)	167	78	42	57	63	
Other	0	0	5	0	0	Imputation (%)	100	100	100	100	100	
Funding available/(required)	(58)	39	(12)	(0)	18	Pay-out ratio (%)	79	150	0	0	0	
Dividends paid	(47)	(20)	0	0	0	Cash Flow (NZ\$m)		2018A	2019A	2020E	2021E	2022E
Equity raised/(returned)	(0)	(0)	0	0	0	Operating Performance	2018A	2019A	2020E	2021E	2022E	
(Increase)/decrease in net debt	(105)	19	(12)	(0)	18	Revenue Breakdown (NZ\$m)	2018A	2019A	2020E	2021E	2022E	
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Processing fee revenue	259	242	140	142	158	
Working capital	19	(5)	16	25	29	Natural gas recovery	32	40	26	31	32	
Fixed assets	1,192	1,171	902	864	832	Other refining revenue	14	16	14	12	12	
Intangibles	14	22	12	12	0	Pipeline revenue	44	36	32	39	42	
Right of use asset	0	0	0	0	0	Other revenue	14	14	15	13	13	
Other assets	0	4	3	3	3	Total revenue	362	348	227	237	257	
Total funds employed	1,226	1,193	933	905	876	Processing fee drivers		Operating cost breakdown (NZ\$m)				
Net debt/(cash)	260	242	255	256	238	Refining margin (USD/barrel)	6.2	5.3	2.2	3.2	4.6	
Lease liability	0	0	0	0	0	NZDUSD	0.69	0.66	0.64	0.67	0.68	
Other liabilities	196	191	133	133	133	Throughput (mbls)	40.4	42.7	25.4	31.0	31.0	
Shareholder's funds	769	760	544	514	504	Refining margin (NZD/barrel)	6.2	5.7	2.5	3.4	4.7	
Minority interests	0	0	0	1	1	Fee floor (estimated) (USD/barrel)	3.3	3.0	5.1	4.4	4.5	
Total funding sources	1,226	1,193	933	905	876	Operating cost breakdown (NZ\$m)		Total expenses				
						Process materials and utilities	49	59	48	51	46	
						Natural gas costs	32	40	26	31	32	
						Materials & contractor payments	29	31	19	20	22	
						Wages & salaries	61	61	62	47	48	
						Admin & other expenses	38	39	33	30	26	

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

FY21 processing fee floor

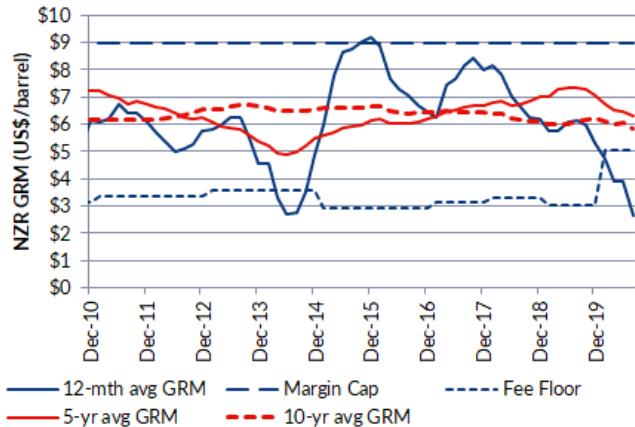
Figure 1. FY21 processing fee floor sensitivity to NZD USD

NZDUSD	0.60	0.62	0.64	0.66	0.68	0.70
Fee floor gross refining margin (US\$/barrel)	\$3.93	\$4.06	\$4.19	\$4.32	\$4.45	\$4.58

Source: Forsyth Barr analysis

Note: The sensitivity assumes a NZ\$ processing fee floor of NZ\$142m and throughput of 31m barrels.

Figure 2. Historic gross refining margin and processing fee floor



Source: NZR, Forsyth Barr analysis

Forecast changes

Figure 3. Forecast changes

	FY20			FY21			FY22		
	Old	New		Old	New		Old	New	
	NZ\$m	NZ\$m	% Chg	NZ\$m	NZ\$m	% Chg	NZ\$m	NZ\$m	% Chg
Processing fees	140	140	0%	145	142	-2%	230	158	-31%
Natural gas recovery	24	26	8%	28	31	11%	41	32	-22%
Other income	61	61	-1%	71	64	-10%	77	67	-13%
Total Revenue	225	227	1%	244	237	-3%	348	257	-26%
Natural gas pass through costs	(24)	(26)	8%	(28)	(31)	11%	(41)	(32)	-22%
Operating costs	(160)	(163)	1%	(154)	(148)	-4%	(167)	(142)	-15%
EBITDA	41	38	-7%	61	58	-6%	141	83	-41%
Depreciation / amortisation	(102)	(88)	-14%	(99)	(87)	-12%	(96)	(87)	-9%
EBIT	(61)	(49)	-19%	(37)	(29)	-21%	44	(4)	
Net interest	(13)	(13)	-1%	(11)	(11)	3%	(9)	(10)	15%
Pre-tax profit	(74)	(62)	-16%	(48)	(40)	-16%	35	(14)	
Tax expense	20	16	-17%	13	11	-16%	(10)	4	
Profit after tax	(54)	(46)	-16%	(34)	(29)	-16%	25	(10)	
Abnormal items	(158)	(158)	0%	-	-		-	-	
Reported Profit	(212)	(203)	-4%	(34)	(33)	-5%	25	(14)	
Earnings per share	-17.4	-15.0	-14%	-11.0	-10.4	-5%	8.1	-4.5	
Dividend per share	0.0	0.0		0.0	0.0		0.0	0.0	
Barrels Processed (000)	23,432	25,432	9%	28,000	31,000	11%	40,000	31,000	-23%
Gross Refining Margin (US\$/barrel)	\$2.17	\$2.23	2%	\$3.67	\$3.23	-12%	\$5.55	\$4.59	-17%
NZDUSD	0.627	0.647	3%	0.650	0.670	3%	0.675	0.675	0%
Capital expenditure (\$m)	(37)	(37)	0%	(65)	(49)	-24%	(75)	(55)	-27%

Source: Forsyth Barr analysis

Figure 4. Price performance

Figure 5. Substantial shareholders

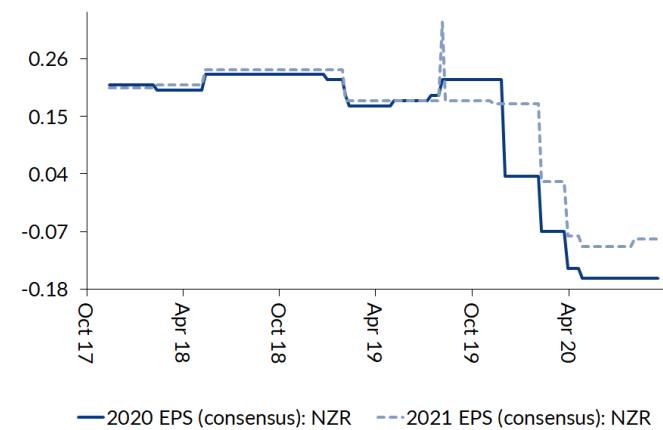
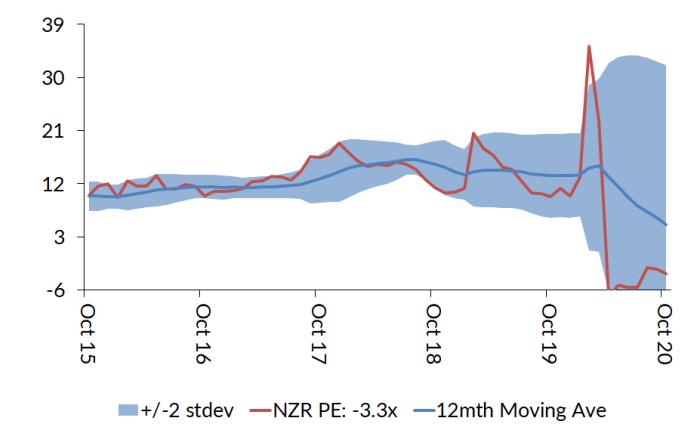
Shareholder	Latest Holding
Mobil Oil NZ Limited	17.2%
Z Energy Holdings Limited	15.4%
BP	10.1%
Wellington Management Company	9.3%
ACC	7.0%

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

Figure 6. International valuation comparisons

Company (metrics re-weighted to reflect NZR's balance date - December)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
Refining NZ	NZR NZ	NZ\$0.61	NZ\$191	<0x	<0x	11.3x	7.5x	<0x	<0x	0.0%
FORMOSA PETROCHEMICAL CORP	6505 TT	TWD80.00	TWD762,077	>50x	21.9x	40.2x	13.2x	>75x	18.5x	3.0%
IDEMITSU KOSAN CO	5019 JP	¥2229.00	¥663,940	4.1x	9.2x	11.5x	7.5x	<0x	23.1x	5.5%
SK INNOVATION CO	096770 KS	KRW139000.00	KRW12,852,713	<0x	23.4x	<0x	8.8x	<0x	20.3x	2.0%
S-OIL CORP	010950 KS	KRW51600.00	KRW5,809,272	<0x	9.1x	>75x	7.9x	<0x	12.2x	3.2%
Compco Average:				4.1x	15.9x	25.9x	9.3x	n/a	18.5x	3.4%
EV = Current Market Cap + Actual Net Debt				NZR Relative:		n/a	n/a	-56%	-20%	n/a
								n/a	n/a	-100%

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

Figure 7. Consensus EPS momentum (NZ\$)

Figure 8. One year forward PE (x)


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	OUTPERFORM	NEUTRAL	UNDERPERFORM
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