

Refining NZ

Stuck on the Floor

ANDREW HARVEY-GREEN

andrew.harvey-green@forsythbarr.co.nz
+64 4 495 8185

SCOTT ANDERSON

scott.anderson@forsythbarr.co.nz
+64 4 914 2219

NEUTRAL

As expected Refining NZ's (NZR) September/October 2020 statistics show another period of operation at fee floor levels, meaning NZR's customers continue to make processing fee top-up payments to the refinery. Notwithstanding customer resistance, NZR is on track to simplify refinery operations by 1 January 2021, reducing refining capacity ~25%. NZR has revealed that Exxon Mobil has paused its dispute over the refinery simplification as the customers focus on terminal conversion discussions (which are ongoing). With NZR expected to operate at the fee floor for the remainder of 2020, we make no changes to our forecasts. There remains a wide range of value outcomes for NZR, with refinery to import terminal conversion costs and terminal/pipeline fee levels critical for investors to be able to assess NZR's value. We retain our NEUTRAL rating.

NZX Code	NZR	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$0.58	NPAT* (NZ\$m)	4.2	-45.8	-29.0	-10.2	PE	43.5	n/a	n/a	n/a
Target price	NZ\$0.80	EPS* (NZc)	1.3	-65.1	-9.3	-3.3	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS growth* (%)	-85.9	n/a	85.7	64.9	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	312.6m	DPS (NZc)	2.0	0.0	0.0	0.0	Price / NTA	0.2	0.3	0.4	0.4
Market cap	NZ\$181m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.4	0.0	0.0	0.0
Avg daily turnover	370.1k (NZ\$326k)	*Based on normalised profits					Gross div yld (%)	4.8	0.0	0.0	0.0

Still operating at fee floor

NZR continues to operate at the fee floor, with top up payments of NZ\$15.8m required from customers for the September/October 2020 period and taking total processing fee revenue to NZ\$23.3m. The Singapore benchmark margin was again negative (-US\$1.64/barrel) and NZR's uplift was a modest +US\$2.79/barrel (the uplift averages US\$3.50/barrel) resulting in a headline NZR GRM of US\$1.15/barrel. November margins so far appear to be higher than the September/October average (refer Figure 5), but not enough to prevent further processing fee top-up payments in the last two months of 2020.

Following the July/August 2020 six-week shut-down, the September/October 2020 throughput was relatively high at 6.2m barrels, the highest since January/February 2020 and ~88% of full capacity.

Refinery simplification work underway

NZR is continuing to progress plans to simplify the refinery (mothballing a crude distillation unit), reducing throughput ~25% to ~31m barrels/annum from 1 January 2021, with ~90 employees to depart by the end of March 2021. The simplification of the refinery will ensure NZR can operate on a cash neutral basis in 2021. However, cutting capacity is a negative for customers as it raises the fee floor from US\$3.0/barrel to ~US\$4.5/barrel and makes using the refinery less attractive.

Conversion discussion ongoing

NZR has indicated that discussions are ongoing and that Exxon Mobil has paused its dispute over the simplification process to focus on the terminal conversion discussions – which is encouraging for a conclusion occurring sooner rather than later and highlights the strong desire from the fuel companies that the refinery converts to an import terminal. In addition, NZR has indicated that a front end engineering and design (FEED) has commenced in the next step to better understanding terminal conversion costs and timing. There is no indication when discussions may be concluded, with NZR saying there will be further updates as work is progressed.

Refining NZ (NZR)

Priced as at 19 Nov 2020 (NZ\$)

0.58

12-month target price (NZ\$)*

0.80

Expected share price return

37.9%

Net dividend yield

0.0%

Estimated 12-month return

37.9%

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

0.86

2. n/a

n/a

3. n/a

n/a

DCF valuation summary (NZ\$m)

Total firm value

653

(Net debt)/cash

(256)

Less: Capitalised operating leases

Value of equity

397

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	362	348	227	237	257
Normalised EBITDA	153	118	38	58	83
Depreciation and amortisation	(97)	(100)	(88)	(87)	(87)
Normalised EBIT	56	18	(49)	(29)	(4)
Net interest	(14)	(13)	(13)	(11)	(10)
Associate income	0	0	0	0	0
Tax	(12)	(1)	16	11	4
Minority interests	0	0	0	0	0
Normalised NPAT	30	4	(46)	(29)	(10)
Abnormals/other	0	0	(158)	0	0
Reported NPAT	30	4	(203)	(29)	(10)
Normalised EPS (cps)	9.5	1.3	(65.1)	(9.3)	(3.3)
DPS (cps)	7.5	2.0	0	0	0

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	-12.6	-3.9	-34.8	4.5	8.4
EBITDA (%)	-30.7	-22.5	-67.7	51.0	44.5
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

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	153	118	38	58	83
Working capital change	(39)	23	(12)	2	0
Interest & tax paid	(25)	(19)	(8)	(11)	(10)
Other	16	(6)	2	0	0
Operating cash flow	105	117	20	49	73
Capital expenditure	(162)	(78)	(37)	(49)	(55)
(Acquisitions)/divestments	0	0	0	0	0
Other	0	0	5	0	0
Funding available/(required)	(58)	39	(12)	(0)	18
Dividends paid	(47)	(20)	0	0	0
Equity raised/(returned)	(0)	(0)	0	0	0
(Increase)/decrease in net debt	(105)	19	(12)	(0)	18

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	19	(5)	16	25	29
Fixed assets	1,192	1,171	902	864	832
Intangibles	14	22	12	12	12
Right of use asset	0	0	0	0	0
Other assets	0	4	3	3	3
Total funds employed	1,226	1,193	933	905	876
Net debt/(cash)	260	242	255	256	238
Lease liability	0	0	0	0	0
Other liabilities	196	191	133	133	133
Shareholder's funds	769	760	544	514	504
Minority interests	0	0	0	1	1
Total funding sources	1,226	1,193	933	905	876

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

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	2.6	3.7	11.3	7.6	5.2
EV/EBIT (x)	7.0	23.6	n/a	n/a	n/a
PE (x)	6.1	43.5	n/a	n/a	n/a
Price/NTA (x)	0.2	0.2	0.3	0.4	0.4
Free cash flow yield (%)	-31.8	21.7	-9.3	-0.3	10.0
Net dividend yield (%)	12.9	3.4	0.0	0.0	0.0
Gross dividend yield (%)	18.0	4.8	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	n/a
Interest cover EBITDA (x)	11.1	8.8	3.0	5.4	8.1
Net debt/ND+E (%)	25.3	24.1	32.0	33.2	32.1
Net debt/EBITDA (x)	1.7	2.0	6.7	4.4	2.9

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	4.0	1.3	-4.5	-2.7	-0.4
Return on equity (%)	3.9	0.5	-8.4	-5.6	-2.0
Return on funds employed (%)	4.6	2.1	-3.7	-2.0	0.4
EBITDA margin (%)	42.1	33.9	16.8	24.3	32.4
EBIT margin (%)	15.3	5.3	-21.8	-12.4	-1.5
Capex to sales (%)	44.8	22.3	16.2	20.8	21.4
Capex to depreciation (%)	167	78	42	57	63
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	79	150	0	0	0

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue Breakdown (NZ\$m)					
Processing fee revenue	259	242	140	142	158
Natural gas recovery	32	40	26	31	32
Other refining revenue	14	16	14	12	12
Pipeline revenue	44	36	32	39	42
Other revenue	14	14	15	13	13
Total revenue	362	348	227	237	257

Processing fee drivers					
Refining margin (USD/barrel)	6.2	5.3	2.2	3.2	4.6
NZDUSD	0.69	0.66	0.64	0.67	0.68
Throughput (mbbls)	40.4	42.7	25.4	31.0	31.0
Refining margin (NZD/barrel)	6.2	5.7	2.5	3.4	4.7

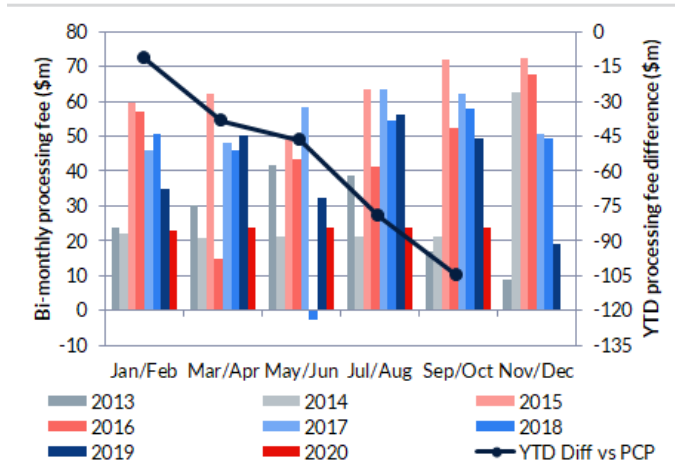
Fee floor (estimated) (USD/barrel)	3.3	3.0	5.1	4.4	4.5
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Operating cost breakdown (NZ\$m)					
Process materials and utilities	49	59	48	51	46
Natural gas costs	32	40	26	31	32
Materials & contractor payments	29	31	19	20	22
Wages & salaries	61	61	62	47	48
Admin & other expenses	38	39	33	30	26
Total expenses	210	230	189	180	174

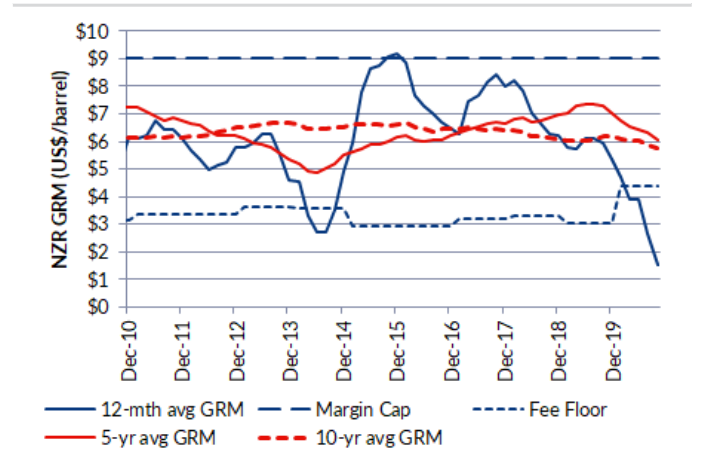
Figure 1. September/October 2020 operating statistics

	Sep/Oct 2019	Jul/Aug 2020	Sep/Oct 2020	% Diff pcp	% Diff mom
Throughput (000 barrels)	7,245	1,766	6,219	-14%	252%
Gross Refining Margin (US\$/barrel)	\$6.16	-\$4.18	\$1.15	-81%	-128%
NZDUSD	0.634	0.660	0.670	6%	2%
NZD processing revenue (NZ\$m)	49.3	23.7	23.3	-53%	-2%
Fee floor payment (NZ\$m)	0.0	31.5	15.8		

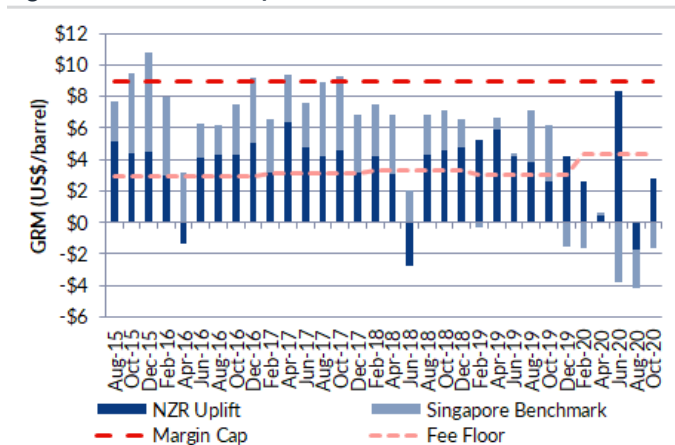
Source: NZR, Forsyth Barr analysis

Figure 2. Historic processing fees


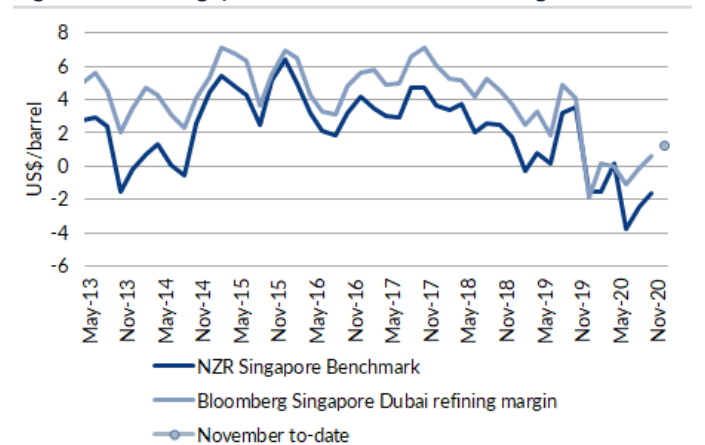
Source: NZR, Forsyth Barr analysis

Figure 3. Historic gross refining margin


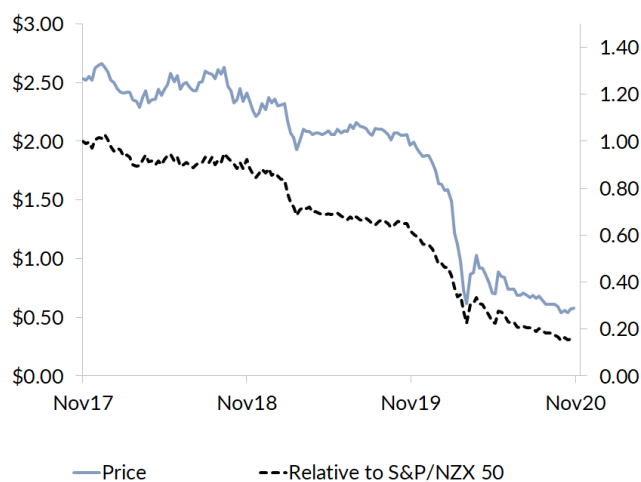
Source: NZR, Forsyth Barr analysis

Figure 4. Historic NZR uplift


Source: NZR, Forsyth Barr analysis

Figure 5. NZR Singapore benchmark vs Bloomberg benchmark


Source: NZR, Bloomberg, Forsyth Barr analysis

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. 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%

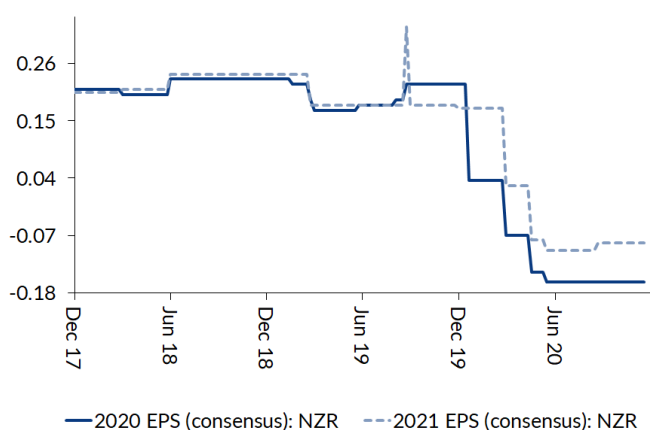
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

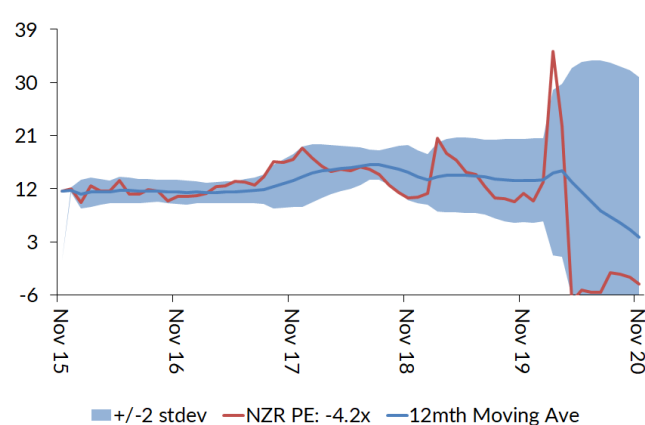
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect NZR's balance date - December)										
Refining NZ	NZR NZ	NZ\$0.58	NZ\$181	<0x	<0x	11.1x	7.3x	<0x	<0x	0.0%
FORMOSA PETROCHEMICAL CORP	6505 TT	TWD93.30	TWD888,772	>50x	26.6x	53.8x	16.3x	>75x	22.0x	2.5%
IDEMITSU KOSAN CO	5019 JP	¥2205.00	¥656,792	12.0x	12.0x	12.0x	7.7x	<0x	19.3x	5.5%
SK INNOVATION CO	096770 KS	KRW156500.00	KRW14,470,861	<0x	>50x	<0x	11.1x	<0x	34.8x	1.5%
S-OIL CORP	010950 KS	KRW67200.00	KRW7,565,564	<0x	16.5x	<0x	9.9x	<0x	18.0x	1.8%
Compco Average:				12.0x	18.4x	32.9x	11.3x	n/a	23.5x	2.8%
NZR Relative:				n/a	n/a	-66%	-35%	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 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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