

Z Energy

OUTPERFORM

Caltex Star Continues to Wane — 3Q20 Operating Statistics

Z Energy's (ZEL) 3Q20 operating statistics can best be described as modest, as expected. Caltex volumes continue to plummet, but Z branded volumes held up well in a declining market and store sales continue to be positive. We've trimmed our FY20 EBITDAF forecast -\$2m to \$358m (-0.5%) due to slightly lower volumes and a cut in NZR's expected dividend. Our target price is down -8cps (-1.7%) to \$4.60.

What's changed?

- **Earnings:** FY20 EBITDAF -\$2m lower to \$358m
- **Target Price:** Reduced -8cps to \$4.60
- **Rating:** OUTPERFORM rating retained

ZEL's 3Q20 operating statistics were generally in line with expectations.

3Q20 key points

- Z branded retail volumes are down just -0.4%, but Caltex volumes are down -16.0% vs. pcp. There is a clear step down in Caltex volumes following its exit from the AA Smartfuels programme, although the rate of volume decline in 3Q20 was slightly better than 2Q20 (-17.4%) and 3Q20 included three months without AA Smartfuels vs. two months in 2Q20.
- Commercial diesel volumes are down -6.1% due to weaker trucking volumes in the upper North Island, and the loss of a commercial contract still coming through the numbers. ZEL has indicated that it has won new volumes pre-Christmas that will lift volumes in FY21 (albeit not materially). ZEL has also indicated that its bio-diesel plant is now operating at full capacity — aiding a recent commercial contract renewal.
- Market share is up slightly (+40bps) on 2Q20, but industry volumes themselves fell an estimated -1.8%.
- Discounting ramped up in 3Q20, largely offsetting higher MBIE margins. ZEL has indicated that its retail margins have improved slightly from 2Q20 levels — but are still well down on pcp.
- The best news story continues to be shop sales, up +7% on the pcp.

Nelson tanks to exit borrow and loan system

ZEL has also confirmed its Nelson tanks are exiting the borrow and loan system as of 3 February. New Nelson terminal contracts are likely to be a small positive for ZEL in due course — although there is nothing changed in our forecasts.

Forecast changes modest (compared to previous changes)

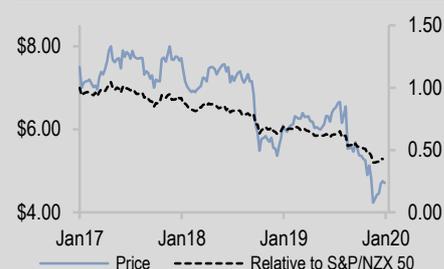
The main changes to our forecasts are from slightly lower volume expectations (but not significantly so) and a lower NZR dividend. We have left our margin assumptions unchanged, although believe there may be some modest upside to our current forecast. FY20/21/22 EBITDAF is down -\$2m/- \$7m/- \$6m respectively. To be a little more conservative we have also removed dividend growth, keeping the dividend flat at 40cps.

Investment View

Our rating is OUTPERFORM. ZEL is offering investors good value, with the market pricing in additional downside that we do not believe is likely to eventuate. ZEL has yet to pull the cost lever and we expect it is looking attractive as a takeover target.

NZX Code	ZEL
Share price	NZ\$4.71
Target price	NZ\$4.60
Risk rating	Medium
Issued shares	400.0m
Market cap	NZ\$1,884m
Avg daily turnover	845.7k (NZ\$4,955k)

Share Price Performance



Financials	19A	20E	21E	22E
NPAT* (NZ\$m)	195.8	126.1	134.1	137.2
EPS* (NZc)	49.0	31.5	33.5	34.3
EPS growth* (%)	-7.4	-35.6	6.4	2.3
DPS (NZc)	43.0	40.0	40.0	40.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	6.0	7.7	7.6	7.6
EV/EBIT	8.4	13.1	12.1	12.0
PE	9.6	14.9	14.1	13.7
Price / NTA	7.5	n/a	39.0	n/a
Cash div yld (%)	9.1	8.5	8.5	8.5
Gross div yld (%)	12.7	11.8	11.8	11.8

*Historic/forecast numbers based on normalised profits

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Z Energy (ZEL)

Priced as at 22 Jan 2020 (NZ\$)

4.71
12-month target price (NZ\$)*
4.60
Spot valuations (NZ\$)

Expected share price return	-2.3%	1. DCF	4.34
Net dividend yield	8.5%	2. Dividend Yield	5.05
Estimated 12-month return	6.2%	3. Market Multiple	4.36

Key WACC assumptions

Risk free rate	2.00%
Equity beta	0.84
WACC	7.2%
Terminal growth	-2.0%

DCF valuation summary (NZ\$m)

Total firm value	3,020
(Net debt)/cash	(972)
Less: Capitalised operating leases	(299)
Value of equity	1,749

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Valuation Ratios	2018A	2019A	2020E	2021E	2022E
Sales revenue	4,570	5,450	5,111	5,051	4,952	EV/EBITDA (x)	6.0	6.0	7.7	7.6	7.6
Normalised EBITDA	448	435	358	379	376	EV/EBIT (x)	7.8	8.4	13.1	12.1	12.0
Depreciation and amortisation	(102)	(122)	(147)	(141)	(137)	PE (x)	8.9	9.6	14.9	14.1	13.7
Normalised EBIT	347	312	210	237	238	Price/NTA (x)	17.6	7.5	60.5	39.0	28.7
Net interest	(52)	(51)	(64)	(64)	(60)	Free cash flow yield (%)	16.1	15.0	-1.6	10.9	11.5
Associate income	1	(1)	(1)	-	-	Net dividend yield (%)	6.9	9.1	8.5	8.5	8.5
Tax	(82)	(61)	(39)	(49)	(50)	Gross dividend yield (%)	9.5	12.7	11.8	11.8	11.8
Minority interests	-	(2)	(19)	(9)	(8)						
Normalised NPAT	211	196	126	134	137	Capital Structure	2018A	2019A	2020E	2021E	2022E
Abnormals/other	(6)	(16)	(35)	-	-	Interest cover EBIT (x)	6.7	6.1	3.3	3.7	4.0
Reported NPAT	205	180	91	134	137	Interest cover EBITDA (x)	8.6	8.5	5.6	5.9	6.3
Normalised EPS (cps)	52.9	49.0	31.5	33.5	34.3	Net debt/ND+E (%)	57.2	55.4	65.1	65.5	65.5
DPS (cps)	32.3	43.0	40.0	40.0	40.0	Net debt/EBITDA (x)	1.8	1.9	3.0	2.8	2.7

Growth Rates	2018A	2019A	2020A	2021A	2022A	Key Ratios	2018A	2019A	2020E	2021E	2022E
Revenue (%)	18.3	19.3	-6.2	-1.2	-2.0	Return on assets (%)	12.4	11.0	6.9	7.9	8.1
EBITDA (%)	6.9	-2.9	-17.8	5.9	-0.9	Return on equity (%)	24.7	21.3	15.4	17.2	18.3
EBIT (%)	3.3	-10.1	-32.7	13.1	0.4	Return on funds employed (%)	17.4	15.8	9.2	10.6	11.1
Normalised NPAT (%)	8.2	-7.4	-35.6	6.4	2.3	EBITDA margin (%)	9.8	8.0	7.0	7.5	7.6
Normalised EPS (%)	8.2	-7.4	-35.6	6.4	2.3	EBIT margin (%)	7.6	5.7	4.1	4.7	4.8
Ordinary DPS (%)	10.2	33.1	-7.0	0.0	0.0	Capex to sales (%)	1.9	1.0	1.7	0.9	0.9

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Operating Performance	2018A	2019A	2020E	2021E	2022E
EBITDA	448	435	358	379	376	Product volumes (m litres)					
Working capital change	61	(159)	24	(6)	8	Petrol	1,204	1,165	1,118	1,120	1,097
Interest & tax paid	(103)	(161)	(132)	(119)	(118)	Diesel - retail	461	454	445	442	429
Other	(15)	223	(192)	(4)	(4)	Diesel - commercial	807	812	790	816	839
Operating cash flow	391	338	57	250	262	Other fuels	1,153	1,193	1,159	1,162	1,177
Capital expenditure	(87)	(55)	(88)	(45)	(45)	Supply - domestic	520	544	544	553	561
(Acquisitions)/divestments	18	(28)	36	-	-	Sub-total	4,145	4,168	4,057	4,093	4,102
Other	12	4	(27)	(24)	(23)	Supply - industry & export	178	280	84	97	96
Funding available/(required)	334	259	(21)	181	193	Total Fuels	4,323	4,448	4,141	4,190	4,197
Dividends paid	(134)	(152)	(198)	(160)	(160)	Retail service stations	343	343	338	332	329
Equity raised/(returned)	(2)	(1)	-	-	-	Petrol/service station (m litres)	3.68	3.57	3.44	3.46	3.39
(Increase)/decrease in net debt	198	106	(219)	21	33	Diesel/service station (m litres)	1.34	1.32	1.31	1.32	1.30

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Gross profit (NZDm)	2018A	2019A	2020E	2021E	2022E
Working capital	196	358	355	361	353	Fuels	685	700	637	617	613
Fixed assets	870	830	806	780	755	Refining	77	54	48	70	68
Intangibles	750	668	785	733	685	Non-fuels	76	81	77	80	82
Right of use asset	-	-	286	286	286	Flick Electric	-	1	4	6	8
Other assets	134	161	219	219	219	Gross profit	838	836	766	774	771
Total funds employed	1,950	2,017	2,451	2,379	2,297	Fuels gross margin (cpl)	16.5	16.8	15.7	15.1	14.9
Net debt/(cash)	824	827	1,085	1,054	1,012	Fuels margin incl refining (cpl)	17.6	17.0	16.5	16.4	16.2
Lease liability	-	-	299	299	299	Fuels margin excl supply (cpl)	18.3	18.0	16.9	16.8	16.6
Other liabilities	269	270	250	244	236						
Shareholder's funds	857	902	817	791	768	Non-fuels revenue/station (NZD C)	373	398	379	398	410
Minority interests	-	18	(1)	(10)	(18)						
Total funding sources	1,950	2,017	2,451	2,379	2,297						

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

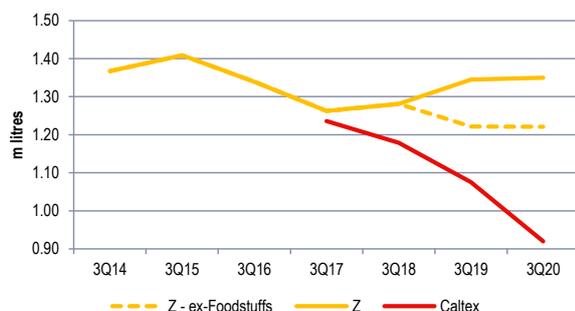
3Q20 operating statistics

Figure 1. 3Q20 operating statistics

	3Q19 Dec-18	2Q20 Sep-19	3Q20 Dec-19	% diff vs pcp	% diff vs pq
Volumes (ml)					
Petrol - Z	197	180	194	-1.5%	7.8%
Petrol - Caltex	109	85	88	-19.3%	3.5%
Petrol - Subtotal	306	265	282	-7.8%	6.4%
Diesel - Z	76	73	78	2.6%	6.8%
Diesel - Caltex	41	34	38	-7.3%	11.8%
Diesel - Subtotal	117	107	116	-0.9%	8.4%
TOTAL Retail	423	372	398	-5.9%	7.0%
Diesel - Commercial	208	186	194	-6.7%	4.3%
Jet/Fuel Oil/Bitumen	327	261	316	-3.4%	21.1%
Supply - Domestic	148	127	145	-2.0%	14.2%
TOTAL Commercial	683	574	655	-4.1%	14.1%
TOTAL Underlying Volume	1,106	946	1,053	-4.8%	11.3%
Supply - Industry & Export	51	24	39		
TOTAL	1,157	970	1,092	-5.6%	12.6%
ZEL retail (as reported)	273	253	272	-0.4%	7.5%
Caltex retail	150	119	126	-16.0%	5.9%
Industry	2,510	2,165	2,390	-4.8%	10.4%
Market share	44.1%	43.7%	44.1%	0.0%	0.8%
Margin (MBIE data) (cpl)					
Petrol - MBIE	35.7	24.8	29.9	-16.3%	20.6%
Diesel - MBIE	39.9	32.7	35.3	-11.6%	8.1%
Transaction volumes - Z (m)					
Fuel only	7.4	6.9	7.4	0.0%	7.2%
Fuel & shop	1.7	1.5	1.6	-5.9%	6.7%
Shop only	5.4	5.2	5.8	7.4%	11.5%
TOTAL	14.5	13.6	14.8	2.1%	8.8%
Weekly shop sales (\$)	37,918	36,286	40,906	7.9%	12.7%
Like-for-like weekly sales (\$)	38,515	36,450	41,208	7.0%	13.1%
Outlet Numbers					
Service stations - Z	203	201	202	-0.5%	0.5%
Service stations - Caltex	139	138	136	-2.2%	-1.4%
Service stations - Total	342	339	338	-1.2%	-0.3%
Truck stops	155	154	154	-0.6%	0.0%

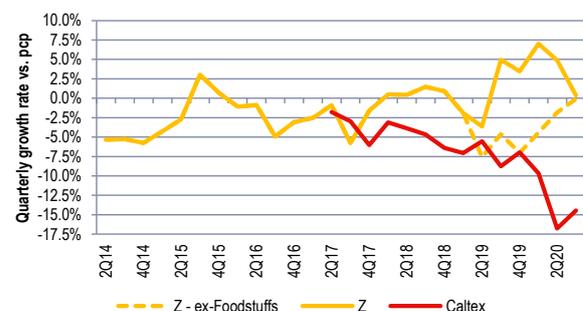
Source: ZEL, Forsyth Barr analysis

Figure 2. 3Q retail volumes / service station



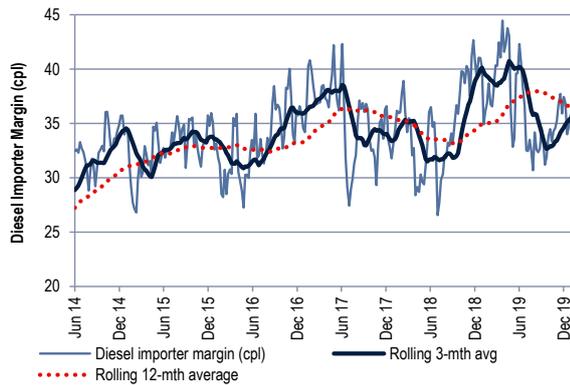
Source: ZEL, Forsyth Barr analysis
Note: Z ex-Foodstuffs volume is estimated

Figure 3. Volume growth / service station



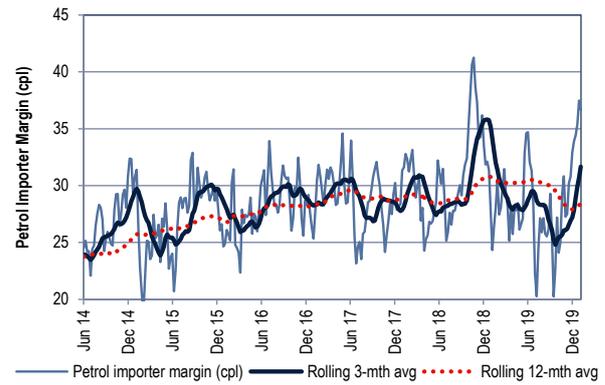
Source: ZEL, Forsyth Barr analysis
Note: Z ex-Foodstuffs volume is estimated

Figure 4. MBIE diesel margins



Source: MBIE, Forsyth Barr analysis

Figure 5. MBIE petrol margins



Source: MBIE, Forsyth Barr analysis

Forecast changes

Figure 6. Forecast changes

	FY20	FY20	%	FY21	FY21	%	FY22	FY22	%
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Revenue	5,152	5,111	-1%	5,131	5,051	-2%	5,043	4,952	-2%
Gross profit	772	767	-1%	787	778	-1%	787	776	-1%
Gross Margin	15.0%	15.0%	0%	15.3%	15.4%	0%	15.6%	15.7%	0%
Operating costs	(411)	(410)	0%	(402)	(399)	-1%	(405)	(401)	-1%
EBITDAF	360	358	-1%	386	379	-2%	382	376	-2%
Depreciation & amortisation	(147)	(147)	0%	(141)	(141)	0%	(137)	(137)	0%
EBIT	214	211	-1%	245	237	-3%	245	238	-3%
Net Interest	(64)	(64)	0%	(64)	(64)	0%	(60)	(60)	0%
Other	(38)	(38)	0%	-	-	-	-	-	-
Pre-tax profit	112	109	-2%	180	173	-4%	185	179	-3%
Tax expense	(39)	(39)	-2%	(51)	(49)	-4%	(52)	(50)	-3%
NPAT	72	70	-3%	130	125	-4%	133	129	-3%
Minority interest	19	19	0%	9	9	0%	8	8	0%
NPAT post-minorities	91	89	-2%	139	134	-4%	142	137	-3%
Normalised Profit	128	126	-2%	139	134	-4%	142	137	-3%
Earnings per share (eps)	32.0	31.5	-2%	34.8	33.5	-4%	35.4	34.3	-3%
Dividend (cps)	40.0	40.0	0%	41.5	40.0	-4%	43.0	40.0	-7%
Key operating assumptions									
Petrol	1,136	1,118	-2%	1,139	1,120	-2%	1,126	1,097	-2%
Diesel - Retail	446	445	0%	438	442	1%	427	429	0%
Diesel - Commercial	805	790	-2%	845	816	-3%	868	839	-3%
Jet	870	866	-1%	897	887	-1%	910	901	-1%
Marine	154	154	0%	132	132	0%	133	133	0%
Bitumen & Other	131	139	6%	142	142	0%	143	143	0%
Domestic supply	551	544	-1%	566	553	-2%	574	561	-2%
ZEL specific vol (m litres)	4,094	4,057	-1%	4,159	4,093	-2%	4,180	4,102	-2%
Industry and export supply	82	84	3%	102	97	-5%	100	96	-5%
Total fuel volumes (m litres)	4,176	4,141	-1%	4,260	4,190	-2%	4,280	4,197	-2%
GM excl supply (cpl)	15.6	15.7	0%	15.0	15.1	0%	14.9	14.9	0%
GM incl refining (cpl)	16.9	16.9	0%	16.8	16.8	0%	16.5	16.6	0%
Gross profit make-up									
Fuels gross profit	641	637	-1%	624	617	-1%	622	613	-1%
Refining gross profit	49	48	-1%	72	70	-2%	69	68	-2%
Non-fuel gross profit	76	77	0%	80	80	1%	82	82	1%
NZR dividend	2	1	-49%	6	4	-33%	6	5	-17%
Flick gross profit	4	4	0%	6	6	0%	8	8	0%
	772	767	-1%	787	778	-1%	787	776	-1%

Source: Forsyth Barr analysis

Investment summary

Our rating is **OUTPERFORM**. Z Energy (ZEL) is offering investors good value, with the market pricing in additional downside that we do not believe is likely to eventuate. ZEL has yet to pull the cost lever and we expect it is looking attractive as a takeover target.

Business quality

- **Industry structure:** The industry is an oligopoly dominated by ZEL, BP, and Mobil (Exxon). ZEL's NZ-centric business model provides it with a market leading position. ZEL sells ~45% of NZ fuel volumes.
- **Refining performance:** ZEL refines ~75% of its product at NZR. NZR is generally a positive and provides a competitive advantage over imported product when refining margins are high.

Earnings and cash flow outlook

- **Fuel margins:** Fuel margins are the key value driver and with retail competition intensifying, are becoming increasingly volatile. Commercial margins remain stable.
- **Sales volumes:** Fuel demand is generally inelastic, so whilst it is an important value driver its variability is less than margins. However, volumes are important for maintaining supply chain economics.
- **Strategy 3.0:** ZEL has guided to earnings growth of +\$35m to +\$40m above underlying FY17 earnings. Growth is predominantly coming from extra Caltex/Z merger benefits and jet fuel being repriced to import parity.

Company description

Z Energy is a downstream oil company. Its products include petrol, diesel, marine fuel oil and aviation fuel. Z retails petrol and diesel through a network of ~200 Z branded service stations and ~140 Caltex branded service stations. It sells fuel to the commercial market, which includes a network of 161 truck stops. ZEL also owns terminal storage facilities in 12 centres, share of local distribution ships and distribution infrastructure, 15% of Refining NZ (NZR), 25% of Loyalty NZ (Fly Buys) and 70% of electricity retailer Flick Electric. It has also recently opened a bio-diesel plant in Wiri, South Auckland.

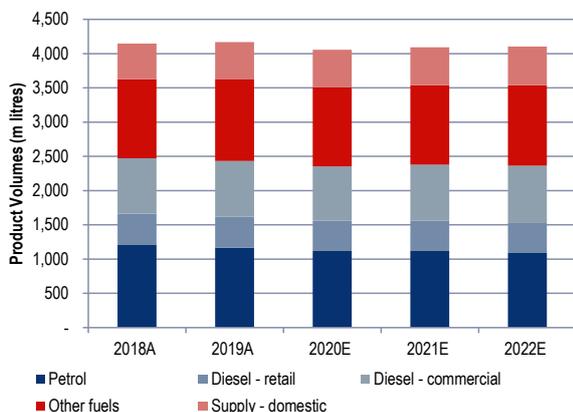
Financial structure

- **Flick Electric:** ZEL has acquired a 70% stake in electricity retailer Flick Electric. We do not expect it to impact on earnings in the near-term.

Key risks

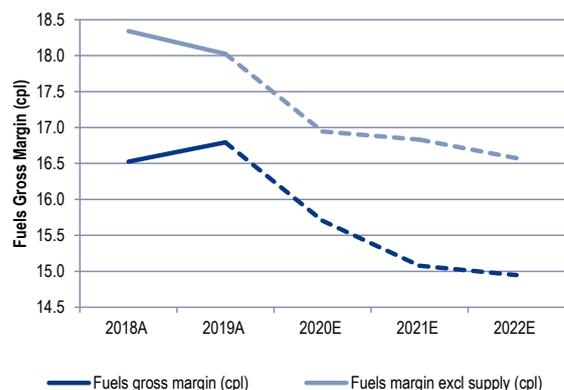
- **Long-term threat to industry volumes:** Increased vehicle efficiency and the threat from electric vehicles will pressure industry volumes. However, the near-term risks are low with industry volumes growing.
- **Retail Fuel Market Study (RFMS):** The RFMS has found that the retail fuel sector is over-earning and that the wholesale market needs opening up via terminal gate pricing. Whilst we do not believe this will have a material impact on sector earnings, it is a risk.

Figure 7. Sales volumes



Source: ZEL, Forsyth Barr analysis

Figure 8. Fuels margin



Source: ZEL, Forsyth Barr analysis

Figure 9. Substantial Shareholders

Shareholder	Latest Holding
Lazard	6.7%
ACC	6.1%
Commonwealth Bank of Australia	6.1%
Investor Mutual	5.1%

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

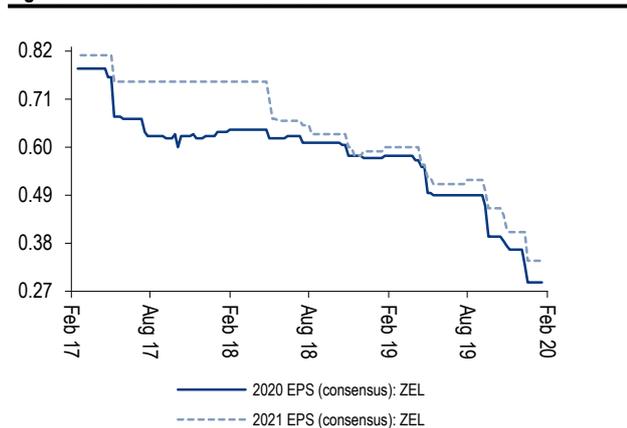
Figure 10. International Compcos

Company	Code	Price	Mkt Cap	PE	EV/EBITDA	EV/EBIT	Cash D/Yld
(metrics re-weighted to reflect ZEL's balance date - March)				2020E	2021E	2020E	2021E
Z Energy	ZEL NZ	NZ\$4.71	NZ\$1,884	14.9x	14.1x	7.6x	7.2x
Suburban Propane Partners LP	SPH US	US\$22.42	US\$1,392	18.1x	15.7x	9.5x	9.2x
World Fuel Services Corp	INT US	US\$40.60	US\$2,655	15.9x	13.8x	7.9x	7.5x
Contact Energy *	CEN NZ	NZ\$7.55	NZ\$5,421	20.6x	20.4x	13.0x	13.0x
Mercury *	MCY NZ	NZ\$5.27	NZ\$7,179	29.1x	26.6x	16.1x	15.8x
Trustpower *	TPW NZ	NZ\$7.46	NZ\$2,335	24.4x	22.8x	14.2x	13.8x
Meridian Energy *	MEL NZ	NZ\$5.39	NZ\$13,815	27.4x	28.7x	17.8x	18.6x
Genesis Energy *	GNE NZ	NZ\$3.21	NZ\$3,305	21.0x	17.8x	12.3x	11.3x
Caltex Australia	CTX AT	A\$34.99	A\$8,737	n/a	17.2x	n/a	n/a
Viva Energy Group	VEA AT	A\$1.84	A\$3,578	n/a	15.8x	9.4x	8.0x
Compcpo Average:				22.4x	19.9x	12.5x	12.1x
ZEL Relative:				-33%	-29%	-40%	-41%
						-38%	-42%
							+65%

EV = Current Market Cap + Actual Net Debt

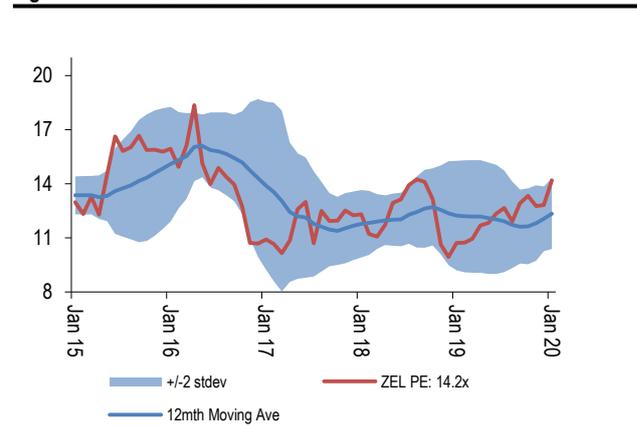
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcpo metrics re-weighted to reflect headline (ZEL) companies fiscal year end

Figure 11. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 12. 12 Month Forward PE



Source: Forsyth Barr analysis

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