

# Z Energy

## Coming Out of Lockdown

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### OUTPERFORM

Following Z Energy's (ZEL) NZ\$347.5m equity raise, our coverage of ZEL comes out of lockdown (restricted coverage) with an OUTPERFORM rating and an NZ\$4.20 target price. Trading in recent weeks has been encouraging, aided by New Zealand moving to Alert Level 1 earlier than we (or ZEL) had expected. In addition, ZEL's structural cost-out plans are greater than we had previously envisaged, boosting the longer-term outlook, ZEL's competitive position with the discounters and confidence that ZEL can produce the earnings to deliver an NZ28cps dividend in FY22.

NZX Code	ZEL	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.90	NPAT* (NZ\$m)	102.2	43.7	127.5	147.9	EV/EBITDA	6.5	9.3	6.2	5.8
Target price	NZ\$4.20	EPS* (NZc)	25.6	8.4	24.5	28.4	EV/EBIT	11.8	22.6	10.3	9.1
Risk rating	Medium	EPS growth* (%)	-47.8	-67.2	n/a	16.0	PE	11.4	34.6	11.8	10.2
Issued shares	520.1m	DPS (NZc)	16.5	0.0	28.0	28.0	Price / NTA	n/a	6.1	4.1	3.7
Market cap	NZ\$1,508m	Imputation (%)	100	100	100	100	Cash div yld (%)	5.7	0.0	9.7	9.7
Avg daily turnover	988.6k (NZ\$4,190k)	*Based on normalised profits					Gross div yld (%)	7.9	0.0	13.4	13.4

### Coming out of lockdown better than expected, structural cost-out story better than expected

New Zealand's move to Alert Level 1 has come almost three months earlier than we had envisaged. In addition, sales volumes under each Alert Level have tended to be better than expected. That is the main driver of the +\$NZ17m lift in our FY21 EBITDAF forecast to NZ\$255m.

At the FY20 result, ZEL indicated it is removing -NZ\$55m of structural costs (~-14%) from its opex base, -NZ\$48m in FY21. This is better than we had been forecasting and is the key driver of our longer-term forecast improvements. Typically cost-out initiatives are lower risk and ZEL has indicated that (at this early stage) its plans are on target.

### We forecast dividend reinstatement at the 1H22 result (September 2021) of NZ10cps (and FY22 dividend of NZ28cps)

We are forecasting dividends to resume in FY22 at NZ28cps (1H22 dividend of NZ10cps). Whilst this is -NZ2cps lower than our pre-equity raise forecast, in NZ\$ terms it is a +21% increase. The reduction of debt (due to the equity raise and no FY21 dividend as previously forecast) means ZEL does not have to repay debt as quickly as previously envisaged. Our NZ\$146m dividend forecast is -9% lower than ZEL's pre COVID-19 dividend guidance of NZ40cps (NZ\$160m), and our FY22 EBITDAF forecast of NZ\$353m is above the bottom end of ZEL's pre COVID-19 FY20 guidance range. i.e. based on prior ZEL guidance, our FY22 EBITDAF forecast could theoretically support a dividend slightly above NZ30cps. We are, therefore, increasingly confident that ZEL will be able to reinstate its dividend to at least NZ25cps (assuming no more black swans appear).

### Market position post COVID-19 will improve

Looking longer-term, COVID-19 should improve ZEL's competitive position. First, some of the discounters have pulled back on expansion plans (although we note NPD has decided to expand in the North Island instead of the South Island). Second, some of the lower volume sites in New Zealand will be struggling. Service stations closures should help ZEL regain some of its lost market share.

## Z Energy (ZEL)

Priced as at 15 Jun 2020 (NZ\$)

2.90

<b>12-month target price (NZ\$)*</b>						<b>Spot valuations (NZ\$)</b>					
Expected share price return						1. DCF					4.11
Net dividend yield						2. Dividend Yield					3.70
Estimated 12-month return						3. Market Multiple					3.86
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>					
Risk free rate						Total firm value					3,040
Equity beta						(Net debt)/cash					(733)
WACC						Less: Capitalised operating leases					0
Terminal growth						Value of equity					2,307
<b>Profit and Loss Account (NZ\$m)</b>						<b>Valuation Ratios</b>					
Sales revenue	2019A	2020A	2021E	2022E	2023E	EV/EBITDA (x)	2019A	2020A	2021E	2022E	2023E
Normalised EBITDA	435.0	366.0	254.9	353.4	375.0	EV/EBIT (x)	7.2	11.8	22.6	10.3	9.1
Depreciation and amortisation	(122.0)	(163.0)	(150.7)	(142.8)	(136.6)	PE (x)	5.9	11.4	34.6	11.8	10.2
Normalised EBIT	312.0	203.0	104.3	210.6	238.3	Price/NTA (x)	4.6	n/a	6.1	4.1	3.7
Net interest	(51.0)	(66.0)	(56.4)	(45.1)	(42.9)	Free cash flow yield (%)	18.8	14.2	2.3	8.9	13.8
Associate income	(1.0)	0	0	0	0	Net dividend yield (%)	14.8	5.7	0.0	9.7	9.7
Tax	(61.0)	13.0	(13.4)	(46.3)	(54.7)	Gross dividend yield (%)	20.6	7.9	0.0	13.4	13.4
Minority interests	(2.0)	(16.0)	(9.2)	(8.3)	(7.2)	<b>Capital Structure</b>					
Normalised NPAT	195.8	102.2	43.7	127.5	147.9	Interest cover EBIT (x)	2019A	2020A	2021E	2022E	2023E
Abnormals/other	(15.8)	(42.2)	0	0	0	Interest cover EBITDA (x)	6.1	3.1	1.8	4.7	5.6
Reported NPAT	180.0	60.0	43.7	127.5	147.9	Net debt/ND+E (%)	8.5	5.5	4.5	7.8	8.7
Normalised EPS (cps)	49.0	25.6	8.4	24.5	28.4	Net debt/EBITDA (x)	55.4	72.4	47.5	42.8	40.6
DPS (cps)	43.0	16.5	0	28.0	28.0	<b>Key Ratios</b>					
<b>Growth Rates</b>						Return on assets (%)	2019A	2020A	2021E	2022E	2023E
Revenue (%)	2019A	2020A	2021E	2022E	2023E	Return on equity (%)	11.0	6.7	3.5	6.8	7.6
EBITDA (%)	19.3	-8.5	-43.5	39.0	4.9	Return on funds employed (%)	21.3	17.0	4.5	12.2	14.1
EBIT (%)	-2.9	-15.9	-30.3	38.6	6.1	EBITDA margin (%)	15.8	13.2	4.9	9.9	11.6
Normalised NPAT (%)	-10.1	-34.9	-48.6	>100	13.1	EBIT margin (%)	8.0	7.3	9.1	9.0	9.1
Normalised EPS (%)	-7.4	-47.8	-57.3	>100	16.0	Capex to sales (%)	5.7	4.1	3.7	5.4	5.8
Ordinary DPS (%)	-7.4	-47.8	-67.2	>100	16.0	Capex to depreciation (%)	1.0	2.0	1.6	1.2	1.1
	33.1	-61.6	-100.0	n/a	0.0	Imputation (%)	85	126	57	58	60
<b>Cash Flow (NZ\$m)</b>						Pay-out ratio (%)	2019A	2020A	2021E	2022E	2023E
EBITDA	2019A	2020A	2021E	2022E	2023E	88	65	0	114	98	
Working capital change	435.0	366.0	254.9	353.4	375.0	<b>Operating Performance</b>					
Interest & tax paid	(159.0)	268.0	(93.6)	(68.9)	(9.4)	Product volumes (m litres)	2019A	2020A	2021E	2022E	2023E
Other	223.0	(194.0)	(4.0)	(4.0)	(4.0)	Petrol	1,165	1,099	904	1,061	1,077
Operating cash flow	338.0	316.0	80.3	181.0	255.0	Diesel - retail	454	445	367	429	436
Capital expenditure	(55.0)	(102.0)	(45.5)	(46.0)	(47.2)	Diesel - commercial	812	769	684	740	763
(Acquisitions)/divestments	(28.0)	21.0	0	0	0	Other fuels	1,193	1,120	424	798	990
Other	4.0	(29.0)	(32.0)	(32.0)	(32.0)	Supply - domestic	544	537	464	523	528
Funding available/(required)	259.0	206.0	2.8	102.9	175.8	Sub-total	4,168	3,970	2,843	3,551	3,795
Dividends paid	(152.0)	(203.0)	0	(52.0)	(139.9)	Supply - industry & export	280	67	39	95	94
Equity raised/(returned)	(1.0)	0	342.5	0	0	Total Fuels	4,448	4,037	2,882	3,646	3,889
(Increase)/decrease in net debt	106.0	3.0	345.3	50.9	35.8	Retail service stations	343	334	331	330	333
<b>Balance Sheet (NZ\$m)</b>						Petrol/service station (m litres)	2019A	2020A	2021E	2022E	2023E
Working capital	2019A	2020A	2021E	2022E	2023E	Diesel/service station (m litres)	3.60	3.41	2.83	3.33	3.37
Fixed assets	358.0	119.0	216.6	285.5	294.9	Gross profit (NZDm)	1.32	1.30	1.08	1.29	1.32
Intangibles	830.0	819.0	790.1	762.3	736.1	Fuels	700	666	550	601	617
Right of use asset	668.0	786.0	729.7	680.8	637.6	Refining	54	37	(16)	39	54
Other assets	0	282.0	282.0	282.0	282.0	Non-fuels	81	76	66	75	77
Total funds employed	161.0	253.0	249.0	249.0	249.0	Flick Electric	1	2	6	8	10
Net debt/(cash)	2,017.0	2,259.0	2,267.4	2,259.5	2,199.6	Gross profit	836	781	607	723	758
Lease liability	827.0	1,083.0	721.7	654.8	602.9	Fuels gross margin (cpl)	16.8	16.8	19.4	16.9	16.3
Other liabilities	0	299.0	299.0	299.0	299.0	Fuels margin incl refining (cpl)	17.0	17.4	18.5	17.6	17.2
Shareholder's funds	270.0	275.0	267.8	259.6	250.7	Fuels margin excl supply (cpl)	18.0	17.7	18.8	18.0	17.6
Minority interests	902.0	600.0	986.2	1,061.6	1,069.6	Non-fuels revenue/station (NZD 000)	2019A	2020A	2021E	2022E	2023E
Total funding sources	18.0	2.0	(7.2)	(15.5)	(22.7)	397	373	330	373	385	

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

## Forecasts are reinstated ahead of our pre-FY20 result forecast

Our FY21 EBITDAF forecast is NZ\$255m, up +NZ\$17m on our forecast before ZEL's equity raising announced at the FY20 result. In essence, trading conditions have been better over the past six weeks than previously expected, with NZ moving to Alert Level 1 faster than expected. In summary, our key forecast changes are:

- The move to Alert Level 1 has increased our retail volume forecast +5%. In addition, jet and marine volumes have been better than expected (albeit off a very low base).
- Retail gross margins have declined a little faster than expected so we have trimmed our FY21 gross margin assumption -0.5cpl and -0.4cpl in FY22 (which is the main driver of our lower FY22 EBITDAF forecast).
- Higher volumes boost the short-term use of the refinery (2H21 story), although we expect a slower recovery in FY22 and FY23.
- ZEL is indicating a stronger than expected recovery in non-fuel margins (the last week was ahead of the pcpl).
- We have increased our FY20 operating cost assumption on higher volumes and to align to ZEL's guidance. However, longer-term ZEL's cost-out is better than forecast. We assume ZEL does not have to dip into any of its "contingency" cost-out plans.
- We assume when ZEL's dividend is reinstated in FY22 it will be NZ28cps, -NZ2cps lower than previously forecast (but up +21% to NZ\$146m post-equity raise).

**Figure 1. Forecast changes**

NZ\$m	FY21		%	FY22		%	FY23		%
	Old	New		Chg	Old		New	Chg	
Revenue	2,759	2,817	2%	3,968	3,916	-1%	4,154	4,108	-1%
<b>Gross profit</b>	<b>583</b>	<b>607</b>	<b>4%</b>	<b>747</b>	<b>723</b>	<b>-3%</b>	<b>767</b>	<b>758</b>	<b>-1%</b>
Gross Margin	21.1%	21.6%	2%	18.8%	18.5%	-2%	18.5%	18.5%	0%
Operating costs	(345)	(352)	2%	(385)	(369)	-4%	(400)	(383)	-4%
<b>EBITDAF</b>	<b>238</b>	<b>255</b>	<b>7%</b>	<b>362</b>	<b>353</b>	<b>-2%</b>	<b>367</b>	<b>375</b>	<b>2%</b>
Depreciation & amortisation	(141)	(151)	7%	(137)	(143)	4%	(133)	(137)	2%
<b>EBIT</b>	<b>96</b>	<b>104</b>	<b>8%</b>	<b>225</b>	<b>211</b>	<b>-6%</b>	<b>233</b>	<b>238</b>	<b>2%</b>
Net Interest	(57)	(56)	-1%	(51)	(45)	-12%	(50)	(43)	-14%
<b>Pre-tax profit</b>	<b>40</b>	<b>48</b>	<b>21%</b>	<b>174</b>	<b>166</b>	<b>-5%</b>	<b>183</b>	<b>195</b>	<b>7%</b>
Tax expense	(11)	(13)	21%	(49)	(46)	-5%	(51)	(55)	7%
<b>NPAT</b>	<b>29</b>	<b>34</b>	<b>21%</b>	<b>125</b>	<b>119</b>	<b>-5%</b>	<b>132</b>	<b>141</b>	<b>7%</b>
Minority interest	9	9	0%	8	8	0%	7	7	0%
<b>NPAT post-minorities</b>	<b>38</b>	<b>44</b>	<b>16%</b>	<b>133</b>	<b>127</b>	<b>-4%</b>	<b>139</b>	<b>148</b>	<b>6%</b>
Earnings per share (eps)	9.4	8.4	-11%	33.4	24.5	-27%	34.8	28.4	-18%
Dividend (cps)	20.0	-	-100%	30.0	28.0	-7%	30.0	28.0	-7%
<b>Key operating assumptions - volumes and margin</b>									
Retail - petrol	865	904	5%	1,062	1,061	0%	1,078	1,077	0%
Retail - diesel	346	367	6%	424	429	1%	430	436	1%
Commercial - diesel	678	684	1%	759	740	-2%	778	763	-2%
Commercial - jet	200	227	14%	562	554	-2%	738	728	-1%
Commercial - marine	68	79	16%	102	107	5%	127	124	-2%
Commercial - bitumen & other	142	118	-17%	143	137	-4%	144	139	-3%
Domestic supply	455	464	2%	528	523	-1%	532	528	-1%
<b>ZEL specific volumes (m litres)</b>	<b>2,754</b>	<b>2,843</b>	<b>3%</b>	<b>3,580</b>	<b>3,551</b>	<b>-1%</b>	<b>3,828</b>	<b>3,795</b>	<b>-1%</b>
Industry and export supply	55	39	-30%	95	95	0%	94	94	0%
<b>Total fuel volumes (m litres)</b>	<b>2,809</b>	<b>2,882</b>	<b>3%</b>	<b>3,675</b>	<b>3,646</b>	<b>-1%</b>	<b>3,922</b>	<b>3,889</b>	<b>-1%</b>
GM excl supply (cpl)	19.9	19.4	-3%	17.3	16.9	-2%	16.3	16.3	0%
GM incl refining (cpl)	18.9	18.8	-1%	18.6	18.0	-3%	17.7	17.6	0%
<b>Gross profit make-up</b>									
Fuels gross profit	549	550	0%	619	601	-3%	623	617	-1%
Refining gross profit	(28)	(16)	-44%	47	39	-17%	56	54	-4%
Non-fuel gross profit	55	66	20%	73	75	2%	77	77	0%
NZR dividend	-	-	-	-	-	-	-	-	-
Flick gross profit	6	6	0%	8	8	0%	10	10	0%
	<b>583</b>	<b>607</b>	<b>4%</b>	<b>747</b>	<b>723</b>	<b>-3%</b>	<b>767</b>	<b>758</b>	<b>-1%</b>

Source: Forsyth Barr analysis

Note: Our old forecast was set on 24 April, so included consideration of COVID-19, but did not include FY20 result related revisions or equity raise revisions.

## Volumes and margins indicate retail performance is sound

We estimate that ~55% of NZR's gross margin is from the retail segment (~60% including store sales), hence, it is a core value driver of the business. Normally the key focus is on margins as volumes do not change materially from period to period (although volumes have been declining steadily in recent years). COVID-19 has changed that, with volumes more volatile than margins.

### Volumes largely in line with expectations, but move to Alert Level 1 faster than expected

ZEL's product volumes (up to Alert Level 2) have largely been in line with our and ZEL's expectations (particularly retail volumes) and where there is a volume difference, the variance has generally been positive. The key volume related change to our forecast has been the fact that the move to Alert Level 1 has been ~3 months faster than expected, which benefits retail volumes in particular. Alert Level 3 volumes were also better than expected, although the country was only in Alert Level 3 for a little over two weeks, so the impact on earnings is immaterial.

Alert Level 1 retail volumes will be critical to performance as we estimate ~75% of 1H21 volumes will be at Alert Level 1.

With commercial volumes under Alert Level 2 better than expected, we have assumed that commercial volumes track only -5% below normal (old forecast was -10%) under Alert Level 1 (consistent with ZEL's guidance). However, we are more bullish than ZEL with regard to Alert Level 1 retail volumes – our forecast is a decline of -10%, vs. ZEL guidance of -15%. Alert Level 2 retail volumes were down -17% and we anticipate the volume uplift to Alert Level 1 will be greater than +2%.

Figure 2. Forsyth Barr weeks and expected volume decline vs. actual at each Alert Level (AL)

	Actual				FB Estimate				Difference			
	AL1	AL2	AL3	AL4	AL1	AL2	AL3	AL4	AL1	AL2	AL3	AL4
<b>Weeks at each Alert Level</b>												
Start date	10-Jun	14-May	28-Apr	26-Mar								
Finish date		9-Jun	13-May	27-Apr								
Weeks (in 1H21)	16.1	3.9	2.3	3.9	3.1	16.0	3.0	4.0	13.0	-12.1	-0.7	-0.1
<b>Weekly expected volume decline vs. actual at each Alert Level</b>												
Retail (petrol & diesel)		-17%	-50%	-78%	-10%	-20%	-60%	-80%		3%	10%	2%
Domestic retail supply		-24%	-27%	-59%	-8%	-16%	-48%	-64%		-8%	21%	5%
Commercial diesel		-11%	-10%	-54%	-5%	-15%	-20%	-60%		4%	10%	6%
Jet		-71%	-79%	-74%	-70%	-85%	-90%	-80%		14%	11%	6%

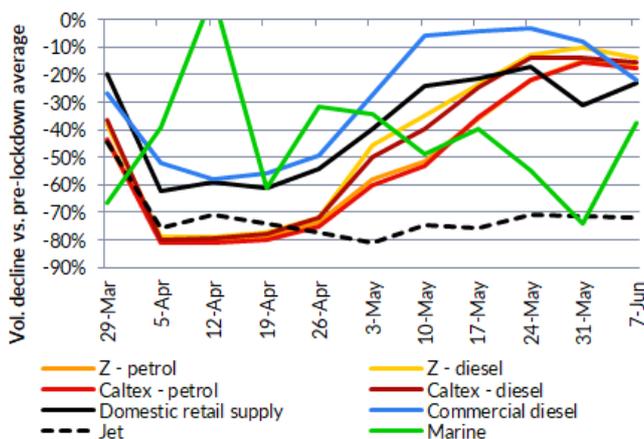
Source: Forsyth Barr analysis

Figure 3. ZEL weekly expected volume decline vs. actual at each Alert Level

	ZEL estimate (per FY20 presentation)				FB estimated actual			Difference		
	AL1	AL2	AL3	AL4	AL2	AL3	AL4	AL2	AL3	AL4
Retail (petrol & diesel)	-15%	-20%	-45%	-80%	-17%	-50%	-78%	3%	-5%	2%
Domestic retail supply	-15%	-20%	-45%	-80%	-24%	-27%	-59%	-4%	18%	21%
Commercial diesel	-5%	-15%	-30%	-45%	-11%	-10%	-54%	4%	20%	-9%
Jet	-75%	-75%	-80%	-85%	-71%	-79%	-74%	4%	1%	11%

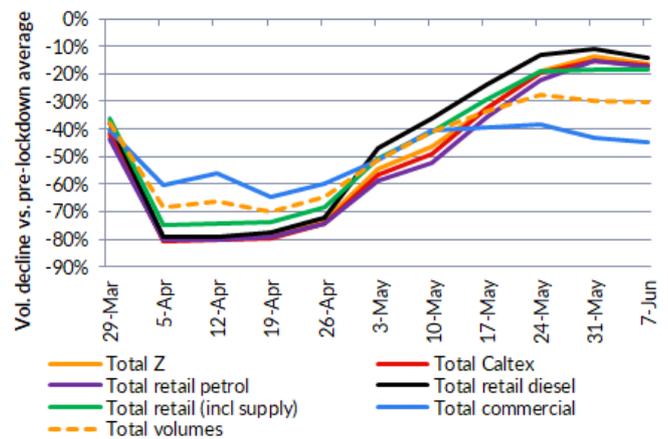
Source: ZEL, Forsyth Barr analysis

Figure 4. Volume decline vs. pre-lockdown average by product



Source: ZEL, Forsyth Barr analysis

Figure 5. Vol. decline vs. pre-lockdown avg. by brand/category



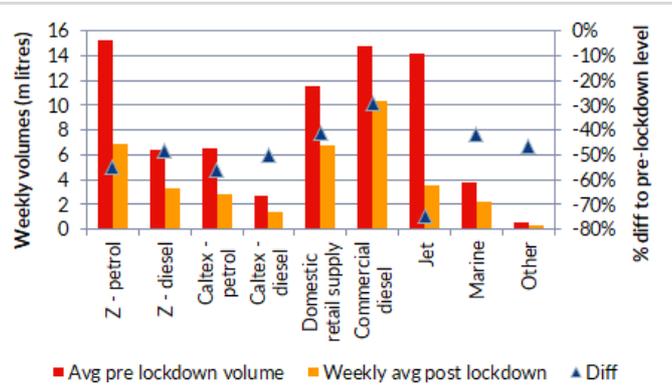
Source: ZEL, Forsyth Barr analysis

**Figure 6. Weekly fuel volumes pre and post-lockdown**

m litres	Average pre-lockdown vol	Weekly average post-26 March	% diff to pre-lockdown vol
<b>Volumes by brand/product</b>			
Z - petrol	15.2	6.8	-55%
Z - diesel	6.4	3.3	-48%
Caltex - petrol	6.5	2.9	-56%
Caltex - diesel	2.8	1.4	-50%
Domestic retail supply	11.6	6.8	-41%
Commercial diesel	14.7	10.4	-29%
Jet	14.2	3.6	-75%
Marine	3.8	2.2	-42%
Other	0.6	0.3	-47%
<b>Volumes by category</b>			
Total Z	21.6	9.1	-58%
Total Caltex	9.2	3.8	-59%
Total retail petrol	21.7	8.6	-60%
Total retail diesel	9.1	4.2	-54%
Total retail (incl supply)	42.4	19.5	-54%
Total commercial	33.3	16.2	-51%
<b>Total volumes</b>	<b>75.6</b>	<b>35.7</b>	<b>-53%</b>

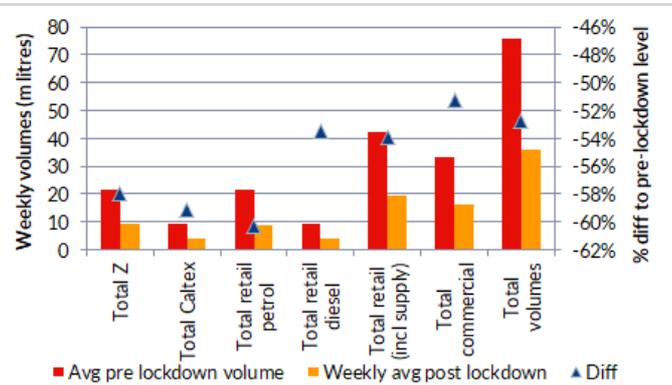
Source: ZEL, Forsyth Barr analysis

**Figure 7. Weekly volumes by product**



Source: ZEL, Forsyth Barr analysis

**Figure 8. Weekly volumes by brand/category**



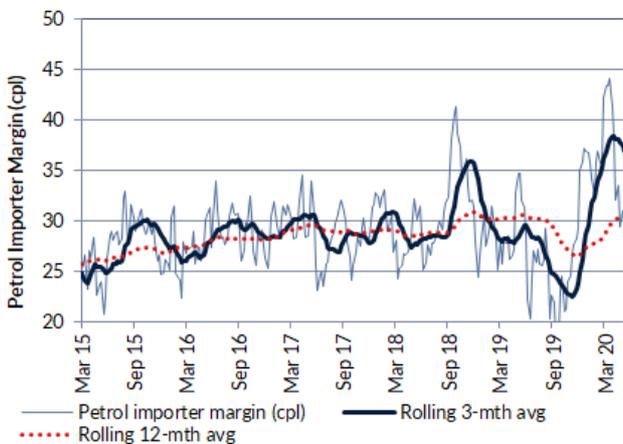
Source: ZEL, Forsyth Barr analysis

**Retail margins still well ahead of pcp, but dipping as volumes increase**

Importer margins surged in 4Q20 due to falling crude prices and then remained elevated in April 2020 during Alert Level 4 to partially offset the dramatic decline in volumes. However, with crude prices rising and volumes recovering, importer margins have started to trend lower, with a noticeable dip in the rolling 3-month margins. Petrol margins in particular are well down, averaging 31.0cpl over the past four-weeks vs. 39.0cpl over the four-weeks prior. The diesel decline is far less pronounced, with the rolling four-week average down only -1.9cpl to 41.6cpl. That said, importer margins are still healthy compared to recent history.

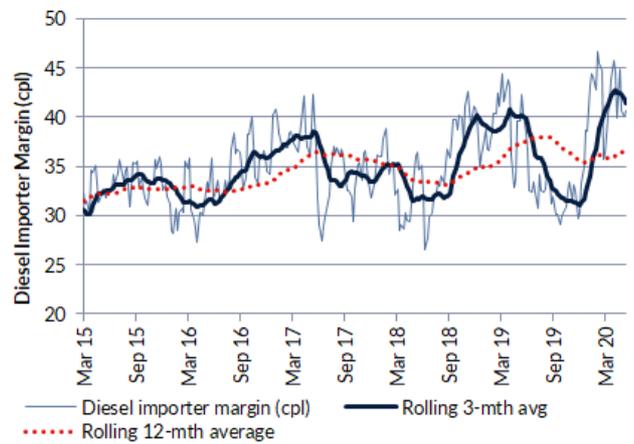
With ZEL no longer seeking to maximise margins, and volumes recovering faster than expected, we have pulled back our margin assumption for FY21 and FY22 in particular (as noted above).

**Figure 9. MBIE importer margins – petrol**



Source: MBIE, Forsyth Barr analysis

**Figure 10. MBIE importer margins – diesel**



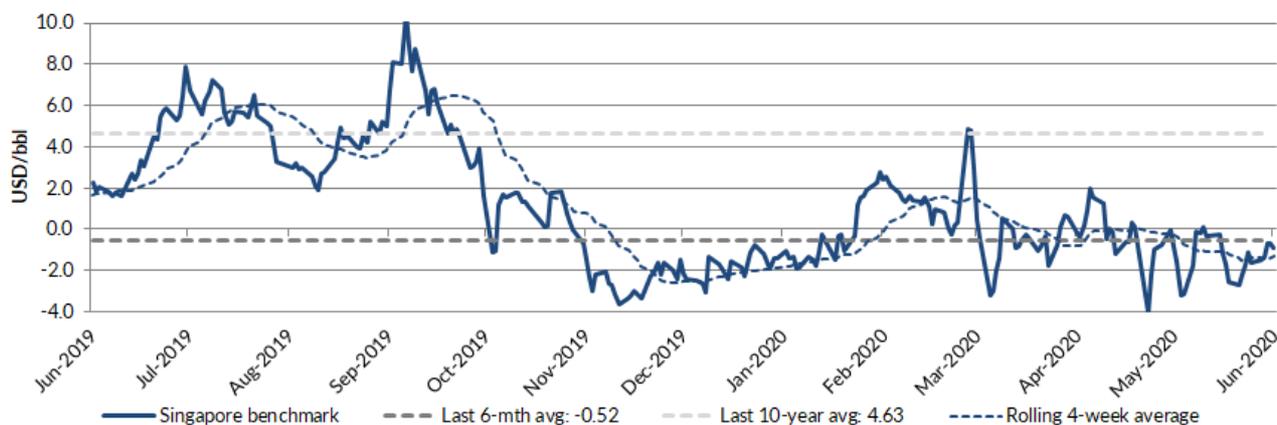
Source: MBIE, Forsyth Barr analysis

## ZEL's headwinds are jet and refinery related

ZEL's earnings headwinds from here are largely jet and refinery related. Retail and commercial volumes should be close to normal under Alert Level 1, such that gross margins from the retail and commercial diesel businesses are not materially lower than pre COVID-19 expectations.

The key earnings headwinds are, therefore, jet volumes being well below average and the refinery (with its issues also largely caused by the collapse in jet volumes). Whilst jet is ZEL's lowest margin product, it is important logistically as it is ~20% of volumes sold. For the refinery, the lack of jet volumes is impacting on refining margins and has forced it to operate at ~50% capacity, and suspend production completely for ~4 weeks in July/August. ZEL's arrangements with the refinery means it has to pay ~NZ\$5.5m per month (~NZ\$65m), regardless of whether it receives any product or not.

**Figure 11. Singapore complex benchmark margin**



Source: Bloomberg, Forsyth Barr analysis

## ZEL's cost-out better than expected for medium-term

ZEL FY21 opex guidance is NZ\$351m, which is higher than expected. However, the structural savings are greater than the one-off savings, hence, our FY22 opex forecast is reduced materially (-NZ\$16m to NZ\$369m). The greater than expected reduction in structural opex is the most significant change to our longer-term forecasts.

Early indications are that ZEL is trading ahead of its base plan, hence, at this stage it seems unlikely it will have to dip into the \$22m of contingency opex savings.

**Figure 12. Operating cost bridge – FY20 to FY22**

	NZ\$m	Comment
<b>FY20 reported opex</b>	<b>416</b>	
less COVID-19 provisions	(24)	Provisions made for costs that are expected to be incurred in FY21
add "normal" bonus level	13	No staff bonuses have been paid in FY20
<b>Underlying FY20 opex</b>	<b>405</b>	
less "structural savings"	(48)	These savings are expected to be ongoing and increase to NZ\$55m in FY22
less "one-off" savings	(15)	NZ\$8m of the one-off cost savings relate to lower volumes, the other NZ\$7m dominated by marketing
add cost inflation	9	
<b>FY21 opex (base figure)</b>	<b>351</b>	Revised FB forecast is NZ\$352m (up +NZ\$7m)
less potential additional one-off savings	(22)	If required, ZEL has identified an additional NZ\$22m of cost savings
<b>FY21 opex ("stressed business" scenario)</b>	<b>329</b>	
<b>FY21 opex (base figure)</b>	<b>351</b>	
less annualised structural savings	(7)	Some of the structural savings in FY21 start part way through the year
add FY21 one-off savings	15	
add cost inflation	9	
<b>FY22 opex (base figure)</b>	<b>368</b>	Revised FB forecast is NZ\$369m (down -NZ\$16m)

Source: ZEL, Forsyth Barr analysis

## Expect dividends to be reinstated between NZ25cps and NZ30cps

Our new FY22 dividend forecast is NZ28cps, down -NZ2cps on our old forecast, but up +21% in NZ\$ terms to NZ\$145.6m (+NZ\$25.6m). A condition of ZEL's debt providers waiving their covenants for the next 12 months is no dividend until the 1H22 result (September 2021). We had previously assumed dividends would resume at the FY21 result.

At this stage ZEL is not changing its dividend policy and indications are it is targeting to repay NZ\$40m of debt per annum. Our old NZ30cps forecast had assumed ZEL would seek to repay debt substantially faster. However, the equity raise and curtailment of the 2H21 dividend obviates that requirement. An NZ28cps dividend still assumes ZEL is able to repay debt at ~NZ\$50m per annum under our revised forecast.

Unless there is another significant negative surprise, we expect the dividend to be reinstated above NZ25cps. Going above NZ30cps is possible but in our view would require earnings to rebound more than expected and/or ZEL to take a less conservative approach on the dividend (which we view as unlikely in light of recent experiences).

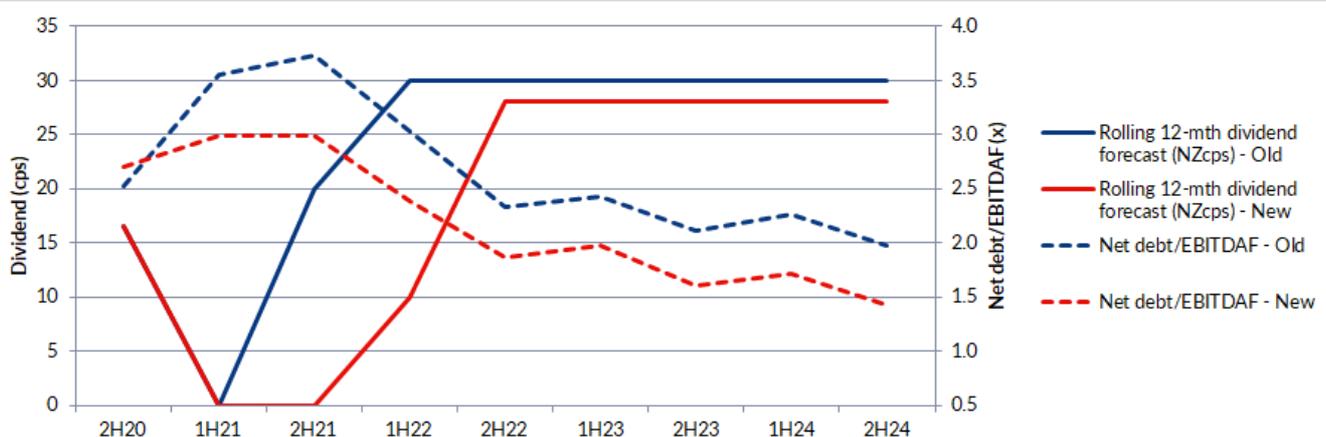
ZEL obtained debt covenant waivers until the 1H22 result (September 2022). Based on our forecasts, we estimate that following the equity raise, ZEL has ~NZ\$175m (~25%) net debt or ~NZ\$58m (~20%) EBITDAF headroom over the debt covenant at 1H22.

**Figure 13. ZEL's dividend and capital position post-equity raise (debt and EBITDAF are presented on a pre-IFRS 16 basis)**

	2H20	1H21	2H21	1H22	2H22	1H23	2H23
Rolling 12-mth dividend forecast (NZcps) - Old	16.5	0.0	20.0	30.0	30.0	30.0	30.0
Rolling 12-mth dividend forecast (NZcps) - New	16.5	0.0	0.0	10.0	28.0	28.0	28.0
Rolling 12-mth dividend forecast (NZ\$m) - Old	66	0	80	120	120	120	120
Rolling 12-mth dividend forecast (NZ\$m) - New	66	0	0	52	146	146	146
Net debt (excl working capital) (NZ\$m) - Old	839	831	776	868	775	817	711
Net debt (excl working capital) (NZ\$m) - New	903	746	667	685	600	657	548
Change in net debt vs. pcp (NZ\$m) - Old			(63)	37	(1)	(51)	(63)
Change in net debt vs. pcp (NZ\$m) - New			(236)	(61)	(67)	(28)	(52)
Rolling 12-mth EBITDAF (NZ\$m) - Old	332	235	208	287	332	336	337
Rolling 12-mth EBITDAF (NZ\$m) - New	335	249	223	286	321	333	343
Net debt/EBITDAF - Old	2.5	3.5	3.7	3.0	2.3	2.4	2.1
Net debt/EBITDAF - New	2.7	3.0	3.0	2.4	1.9	2.0	1.6

Source: Forsyth Barr analysis

**Figure 14. Dividend (cps) and net debt/EBITDAF forecast post-equity raise**



Source: Forsyth Barr analysis

## Investment Summary

Our rating is OUTPERFORM. Whilst ZEL has been negatively impacted by COVID-19 and has been forced to raise new equity, the worst is behind it. Retail and commercial diesel volumes are returning to near normal. We expect ZEL's defensive characteristics to come to the fore over the coming months. Dividend reinstatement at the 1H22 result should be at least 25cps (we are forecasting 28cps).

### 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 cashflow 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 typically less than margins. However, volumes are important for maintaining supply chain economics.
- **COVID-19 uncertainty:** The outbreak of COVID-19 is causing significant uncertainty. On the positive side, falling oil prices helps ZEL's short-term retail margins. Jet fuel volumes are the most impacted, but petrol and diesel will also see a significant demand drop. We expect the demand declines to be relatively short-lived.

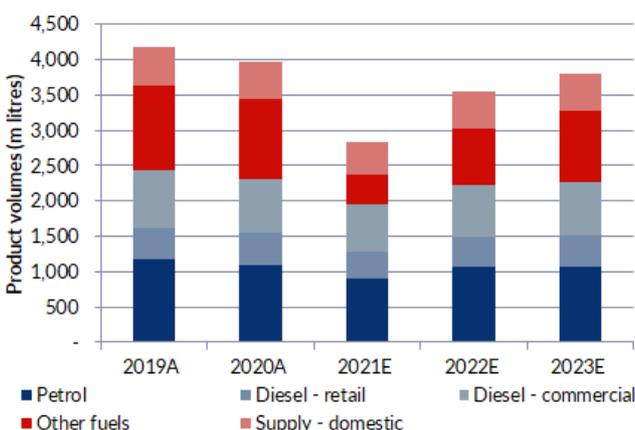
### Financial structure

- **Equity raise:** Due to the negative financial implications from COVID-19, ZEL has raised to \$347.5m of equity, \$290m from an Institutional Placement and up to \$57.5m from a Share Purchase Plan. No dividends will be payable until after 30 September 2021 at the earliest.
- **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.

### Risk factors

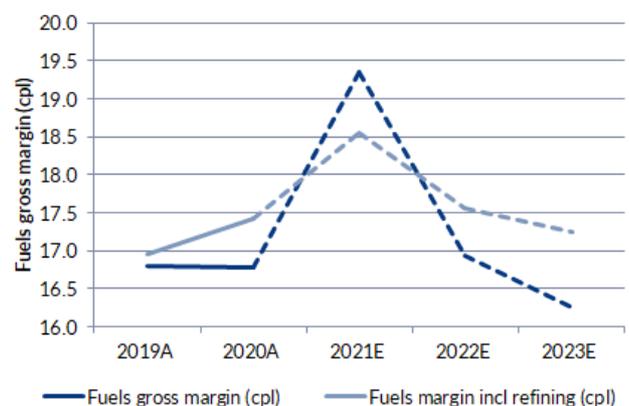
- **Long-term threat to industry volumes:** Increased vehicle efficiency and the threat from electric vehicles will pressure industry volumes. However, the near-term risks are low with industry volumes growing.
- **Retail Fuel Market Study (RFMS):** The RFMS has found that the retail fuel sector is over-earning 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 15. Product volumes

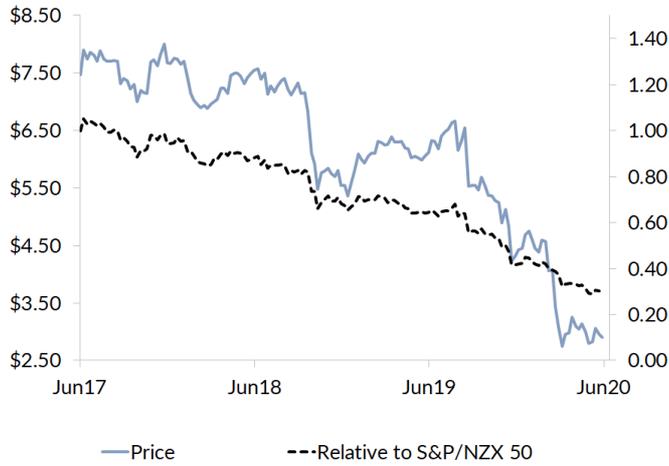


Source: Forsyth Barr analysis

Figure 16. Fuels gross margin



Source: Forsyth Barr analysis

**Figure 17. Price performance**


Source: IRESS, Forsyth Barr analysis

**Figure 18. Substantial shareholders**

Shareholder	Latest Holding
ACC	9.3%
Commonwealth Bank of Australia	6.1%

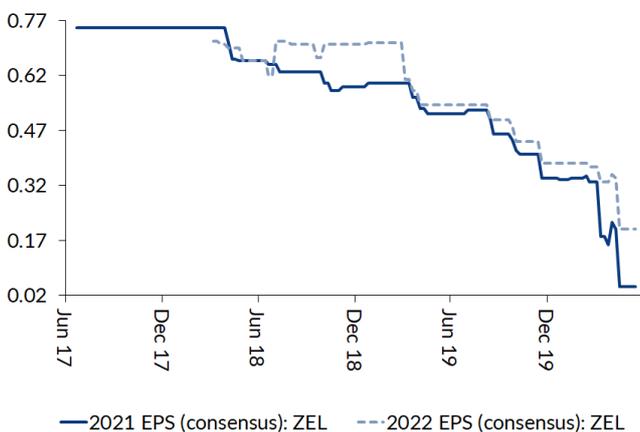
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 19. International valuation comparisons**

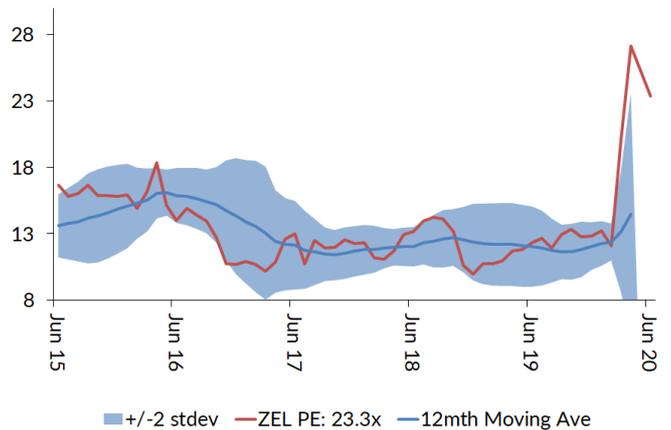
Company (metrics re-weighted to reflect ZEL's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
<b>Z Energy</b>	<b>ZEL NZ</b>	<b>NZ\$2.90</b>	<b>NZ\$1,508</b>	<b>34.6x</b>	<b>11.8x</b>	<b>10.2x</b>	<b>7.3x</b>	<b>24.9x</b>	<b>12.3x</b>	<b>9.7%</b>
SUBURBAN PROPANE PARTNERS LP	SPH US	US\$14.60	US\$907	19.2x	12.7x	9.3x	8.5x	17.9x	16.9x	8.9%
CALTEX AUSTRALIA	CTX AT	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
VIVA ENERGY GROUP	VEA AT	A\$1.58	A\$3,072	<0x	15.9x	11.4x	7.8x	38.8x	15.1x	4.4%
Contact Energy *	CEN NZ	NZ\$6.14	NZ\$4,409	18.4x	17.7x	11.7x	11.3x	22.9x	22.5x	6.4%
Mercury *	MCY NZ	NZ\$4.65	NZ\$6,335	24.9x	23.1x	14.6x	13.9x	24.7x	23.0x	3.8%
Trustpower *	TPW NZ	NZ\$7.07	NZ\$2,213	23.6x	21.8x	14.2x	13.5x	18.6x	17.4x	4.8%
Meridian Energy *	MEL NZ	NZ\$4.76	NZ\$12,198	26.6x	27.0x	16.7x	16.8x	27.1x	27.1x	4.5%
Genesis Energy *	GNE NZ	NZ\$3.05	NZ\$3,164	n/a	n/a	11.3x	10.4x	27.8x	24.6x	5.8%
<b>Compcp Average:</b>				<b>22.5x</b>	<b>19.7x</b>	<b>12.7x</b>	<b>11.7x</b>	<b>25.4x</b>	<b>21.0x</b>	<b>5.5%</b>
<b>ZEL Relative:</b>				<b>53%</b>	<b>-40%</b>	<b>-20%</b>	<b>-38%</b>	<b>-2%</b>	<b>-41%</b>	<b>75%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 20. Consensus EPS momentum (NZ\$)**


Source: Bloomberg, Forsyth Barr analysis

**Figure 21. One year forward PE (x)**


Source: Forsyth Barr analysis

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