

Z Energy

1H Delivered, More Needed – 1H21 Result

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OUTPERFORM

Z Energy (ZEL) did what it needs to do, delivering a solid 1H21 result and providing FY21 EBITDAF guidance that did not disappoint. More of the same is needed though if ZEL is once again to find favour with the market and that will take time. Our forecast changes are minor (FY21 EBITDAF increased +NZ\$5m to NZ\$246m), our target price is unchanged (NZ\$4.35), and we continue to see long-term value in ZEL. If it can continue to avoid negative news, we are confident it will re-rate upwards, particularly on announcement that distributions will resume. Our rating is OUTPERFORM.

NZX Code	ZEL	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.95	NPAT* (NZ\$m)	102.2	22.0	103.2	125.5	PE	11.5	69.9	14.9	12.2
Target price	NZ\$4.35	EPS* (NZc)	25.6	4.2	19.8	24.1	EV/EBIT	11.9	26.2	12.2	10.5
Risk rating	Medium	EPS growth* (%)	-47.8	-83.5	n/a	21.7	EV/EBITDA	6.6	9.6	6.7	6.3
Issued shares	520.1m	DPS (NZc)	16.5	0.0	25.0	25.0	Price / NTA	n/a	5.0	3.9	3.7
Market cap	NZ\$1,534m	Imputation (%)	100	100	100	100	Cash div yld (%)	5.6	0.0	8.5	8.5
Avg daily turnover	1,184k (NZ\$3,904k)	*Based on normalised profits					Gross div yld (%)	7.8	0.0	11.8	11.8

What's changed?

- **Earnings:** FY21 EBITDAF increased +NZ\$5m to NZ\$246m – compares to ZEL FY21 guidance of NZ\$235m to NZ\$265m
- **Target price:** Unchanged at NZ\$4.35/share
- **Rating:** OUTPERFORM rating retained

1H21 result in line with guidance and expectation, but justifies ZEL's cautious approach

1H21 EBITDAF has come in at NZ\$97m (excluding investment income loss of -NZ\$2m), -47% below the pcg and +NZ\$4m better than our forecast. However, included in the result was an NZ\$7m provision release. Strip out that non-cash gain and ZEL's EBITDAF operating result is -NZ\$5m lower than ZEL's mid-point 1H21 EBITDAF guidance – which when first released in July looked conservative i.e. ZEL was justified to be cautious. The refinery contribution was -NZ\$14m, negative for the first time, with fee floor payments of -NZ\$19m a significant headwind. Fuel margins were 16.6cpl (incl refining), -1.4cpl lower than 1H20, with the refinery a -2.7cpl comparator headwind.

Cost out tracking slightly better than expected, and ZEL signals more to come

The main positive from the result is the cost-out programme delivering the expected results and guidance for more cost-out. 1H21 opex was -NZ\$35m lower than the pcg (-NZ\$28m lower excluding the provision reversal). FY21 structural (i.e. ongoing) opex savings are expected to reach NZ\$48m, increasing to NZ\$60m in FY22 and ZEL has indicated it is aiming to lift that to NZ\$70m. The better than expected opex outcome is the main reason for our +NZ\$5m FY21 EBITDAF forecast increase to NZ\$246m. ZEL's FY21 EBITDAF guidance range is NZ\$235m to NZ\$265m.

Dividend/distribution 12 months away

Following its NZ\$347m equity raise and a solid 2Q21 result (after the weak COVID-19 hit 1Q21 result), ZEL's balance sheet is in good position. Net debt (excluding leases) is NZ\$563m. Barring another severe nationwide lockdown, ZEL is on track to resume paying dividends at the 1H22 result. In our view, it is very unlikely that dividends will resume early at the FY21 result. We maintain our current FY22 dividend forecast of 25cps, which equates to a very attractive FY22 gross dividend yield of 11.8%.

Z Energy (ZEL)

Priced as at 04 Nov 2020 (NZ\$)

2.95

12-month target price (NZ\$)*	4.35
Expected share price return	47.5%
Net dividend yield	5.6%
Estimated 12-month return	53.1%

Key WACC assumptions

Risk free rate	1.30%
Equity beta	0.88
WACC	5.8%
Terminal growth	-5.0%

Spot valuations (NZ\$)

1. DCF	4.92
2. Dividend Yield	3.76
3. Market Multiple	4.01

DCF valuation summary (NZ\$m)

Total firm value	3,130
(Net debt)/cash	(573)
Less: Capitalised operating leases	0
Value of equity	2,557

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	5,450	4,987	3,225	3,982	4,146
Normalised EBITDA	435	366	246	320	342
Depreciation and amortisation	(122)	(163)	(154)	(144)	(136)
Normalised EBIT	312	203	90	176	205
Net interest	(51)	(66)	(50)	(49)	(46)
Associate income	(1)	0	(2)	0	0
Tax	(61)	13	(27)	(36)	(45)
Minority interests	(2)	(16)	(7)	(11)	(11)
Normalised NPAT	196	102	22	103	126
Abnormals/other	(16)	(42)	2	0	0
Reported NPAT	180	60	24	103	126
Normalised EPS (cps)	49.0	25.6	4.2	19.8	24.1
DPS (cps)	43.0	16.5	0	25.0	25.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	19	-8	-35	23	4
EBITDA (%)	-3	-16	-33	30	7
EBIT (%)	-10	-35	-56	96	17
Normalised NPAT (%)	-7	-48	-79	>100	22
Normalised EPS (%)	-7	-48	-83	>100	22
Ordinary DPS (%)	33	-62	-100	n/a	0

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	435	366	246	320	342
Working capital change	(159)	268	(127)	(55)	(8)
Interest & tax paid	(161)	(124)	(58)	(92)	(99)
Other	223	(194)	103	(8)	(8)
Operating cash flow	338	316	164	165	227
Capital expenditure	(55)	(102)	(54)	(52)	(53)
(Acquisitions)/divestments	(28)	21	(1)	0	0
Other	4	(29)	(24)	(24)	(24)
Funding available/(required)	259	206	85	89	150
Dividends paid	(152)	(203)	0	(47)	(130)
Equity raised/(returned)	(1)	0	337	0	0
(Increase)/decrease in net debt	106	3	422	42	20

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	358	119	250	305	313
Fixed assets	830	819	790	763	737
Intangibles	668	786	598	553	515
Right of use asset	0	282	280	280	280
Other assets	161	253	163	163	163
Total funds employed	2,017	2,259	2,081	2,064	2,009
Net debt/(cash)	827	1,083	664	610	578
Lease liability	0	299	299	299	299
Other liabilities	270	275	215	207	200
Shareholder's funds	902	600	908	964	960
Minority interests	18	2	(5)	(17)	(28)
Total funding sources	2,017	2,259	2,081	2,064	2,009

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	5.2	6.6	9.6	6.7	6.3
EV/EBIT (x)	7.2	11.9	26.2	12.2	10.5
PE (x)	6.0	11.5	69.9	14.9	12.2
Price/NTA (x)	4.7	n/a	5.0	3.9	3.7
Free cash flow yield (%)	18.4	13.9	7.2	7.3	11.3
Net dividend yield (%)	14.6	5.6	0.0	8.5	8.5
Gross dividend yield (%)	20.2	7.8	0.0	11.8	11.8

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	6.1	3.1	1.8	3.6	4.4
Interest cover EBITDA (x)	8.5	5.5	5.0	6.6	7.4
Net debt/ND+E (%)	55.4	72.4	47.5	43.5	42.3
Net debt/EBITDA (x)	1.9	3.0	2.7	1.9	1.7

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	11.0	6.7	3.5	6.6	7.8
Return on equity (%)	21.3	17.0	2.4	10.9	13.5
Return on funds employed (%)	15.8	13.2	3.5	9.1	10.8
EBITDA margin (%)	8.0	7.3	7.6	8.0	8.2
EBIT margin (%)	5.7	4.1	2.8	4.4	5.0
Capex to sales (%)	1.0	2.0	1.7	1.3	1.3
Capex to depreciation (%)	85	126	68	66	67
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	88	65	0	126	104

Operating Performance	2019A	2020A	2021E	2022E	2023E
Product volumes (m litres)					
Petrol	1,165	1,099	959	1,054	1,049
Diesel - retail	454	445	413	456	454
Diesel - commercial	812	769	760	774	793
Other fuels	1,193	1,120	435	730	875
Supply - domestic	544	537	507	540	542
Sub-total	4,168	3,970	3,074	3,554	3,713
Supply - industry & export	280	67	141	165	169
Total Fuels	4,448	4,037	3,215	3,719	3,881
Retail service stations	343	334	331	330	333
Petrol/service station (m litres)	3.60	3.41	3.00	3.31	3.28
Diesel/service station (m litres)	1.32	1.30	1.22	1.37	1.37
Gross profit (NZDm)					
Fuels	700	666	542	587	595
Refining	54	37	(24)	10	30
Non-fuels	81	76	73	76	78
Flick Electric	1	2	3	4	4
Gross profit	836	781	594	677	707
Fuels gross margin (cpl)	16.8	16.8	17.6	16.5	16.0
Fuels margin incl refining (cpl)	17.0	17.4	16.1	16.1	16.1
Fuels margin excl supply (cpl)	18.0	17.7	16.8	16.7	16.7
Non-fuels revenue/station (NZD 000)	397	373	362	382	390

Forecast changes

Figure 1. Forecast changes

	FY21	FY21	%	FY22	FY22	%	FY23	FY23	%
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Revenue	3,040	3,225	6%	3,944	3,982	1%	4,055	4,146	2%
Gross profit	600	594	-1%	679	677	0%	714	707	-1%
Gross Margin	19.7%	18.4%	-7%	17.2%	17.0%	-1%	17.6%	17.1%	-3%
Operating costs	(359)	(348)	-3%	(365)	(357)	-2%	(375)	(366)	-3%
EBITDAF	241	246	2%	314	320	2%	339	342	1%
Depreciation & amortisation	(151)	(154)	2%	(143)	(144)	1%	(137)	(136)	0%
EBIT	91	92	2%	171	176	3%	202	205	2%
Net Interest	(57)	(50)	-13%	(47)	(49)	4%	(45)	(46)	4%
Other	-	4		-	-		-	-	
Pre-tax profit	34	46	39%	124	128	3%	157	159	1%
Tax expense	(9)	(27)	186%	(35)	(36)	3%	(44)	(45)	1%
NPAT	24	20	-19%	89	92	3%	113	114	1%
Minority interest	9	7	-18%	8	11	35%	7	11	54%
NPAT post-minorities	33	27	-19%	98	103	6%	120	126	4%
Normalised Profit	33	22	-34%	98	103	6%	120	126	4%
Earnings per share (eps)	6.4	4.2	-34%	18.8	19.8	6%	23.1	24.1	4%
Dividend (cps)	-	-		25.0	25.0	0%	25.0	25.0	0%
Key operating assumptions									
ZEL specific volumes (m litres)	3,074	3,074	0%	3,554	3,554	0%	3,713	3,713	0%
Industry and export supply	141	141	0%	165	165	0%	169	169	0%
Total fuel volumes (m litres)	3,215	3,215	0%	3,719	3,719	0%	3,881	3,881	0%
GM excl supply (cpl)	18.0	17.6	-2%	16.4	16.5	1%	15.9	16.0	1%
GM incl refining (cpl)	16.9	16.8	-1%	16.5	16.7	1%	16.6	16.7	1%
Gross profit make-up									
Fuels gross profit	553	542	-2%	582	587	1%	590	595	1%
Refining gross profit	(29)	(24)	-19%	10	10	-2%	32	30	-5%
Non-fuel gross profit	70	73	3%	78	76	-3%	81	78	-4%
NZR dividend	-	-		-	-		-	-	
Flick gross profit	6	3	-54%	8	4	-54%	10	4	-60%
	600	594	-1%	679	677	0%	714	707	-1%

Source: Forsyth Barr analysis

Summary FY21 forecast changes:

- Lowered fuel margins modestly as fuel margins were a little lower than forecast
- Modest increase in refining contribution as there are signs of improvement in short-term refining margins
- Reduced opex forecast -NZ\$9m to NZ\$348m as 1H21 result better than expected
- No change to volume assumptions
- Adjusted interest and tax assumptions in light of 1H21 result

Guidance breakdown

Figure 2. 2H21 guidance analysis — what you have to assume to hit ZEL's guidance

	Low	High	
	NZ\$m	NZ\$m	Comment
FY21 EBITDAF guidance	235	265	
Reported 1H21 EBITDAF	95	95	Includes associate income earnings
Implied 2H21 EBITDAF	140	170	
Fuel margin	294	315	Based on our 2H21 volume assumption of ~1.7b litres, implied fuel gross margin is 17.3cpl to 18.5cpl vs. 17.6cpl in 1H20
Refining contribution	(10)	(5)	ZEL assumes a US\$3/barrel gross refining margin. Refining contribution is very sensitive to this assumption and volume
Non-fuel margin	38	40	2H20 non-fuel margin was NZ\$40m
Other	2	2	Is Flick Electric gross margin
Gross margin	324	352	
Opex	(182)	(180)	Based on cost-out guidance
Associate earnings	(2)	(2)	
Implied 2H21 EBITDAF	140	170	

Source: Forsyth Barr analysis

The greatest uncertainty for ZEL is refining and how much of a headwind that is, and retail fuel margins.

Result analysis

Figure 3. 1H21 result summary

Six months to 30 Sept (NZ\$m)	1H20	1H21	% Diff	FB	\$m Diff	Commentary
Revenue	2,461	1,496	-39%	1,313	183	Average selling price better than expected, but is not a driver of forecasts
Gross Profit	385	264	-31%	271	(7)	Slightly lower fuel margin than forecast
Gross margin (cpl)	18.0c	16.6c	-8%	17.0c	(0.4c)	
Operating costs	(202)	(167)	-17%	(178)	11	Strong cost-out, but NZ\$7m relates to release of COVID-19 related provisions
EBITDAF	183	97	-47%	93	4	
Depreciation & amortisation	(74)	(78)	5%	(76)	(2)	
EBIT	109	19	-83%	17	2	
Net interest	(32)	(26)	-19%	(32)	6	
Other (incl investment income)	(36)	1	n/a	-	1	1H20 included an -NZ\$35m Flick Electric asset impairment
Pre-tax profit	41	(6)	n/a	(15)	9	
Tax expense	(19)	(13)	-32%	4	(17)	Unrealised FX losses distort the tax expense calculation
NPAT	22	(19)	n/a	(11)	(8)	
Minority interest	14	2	-86%	5	(3)	
Abnormal items	35	(2)	n/a	-	(2)	
Normalised Profit	71	(19)	n/a	(6)	(13)	
Earnings per share (cps)	17.8	(3.9)	n/a	(1.2)	(2.7)	
Dividend (cps)	16.5	-	-100%	-	-	No dividend as previously signalled at capital raise

Source: ZEL, Forsyth Barr analysis

Opex bridge

Figure 4. Sources of opex reduction

	1H20 to 1H21	FY20 to FY21	
	NZ\$m	NZ\$m	Comment
1H20/FY20 opex	202	406	
One-off savings			
Reduced demand	(4)	(4)	Costs linked to demand fell due to decline in volumes. No reduction expected in 2H20
Provision reversal	(7)	(7)	A non-cash, low quality cost reduction
Other one-off opex	(7)	(9)	Short-term pull-back in some costs such as marketing
	(18)	(20)	
Structural changes	(22)	(48)	Greater cost savings in 2H as some only started part way through 1H
Inflation	5	10	
1H21/FY21 opex	167	348	

Source: ZEL, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

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

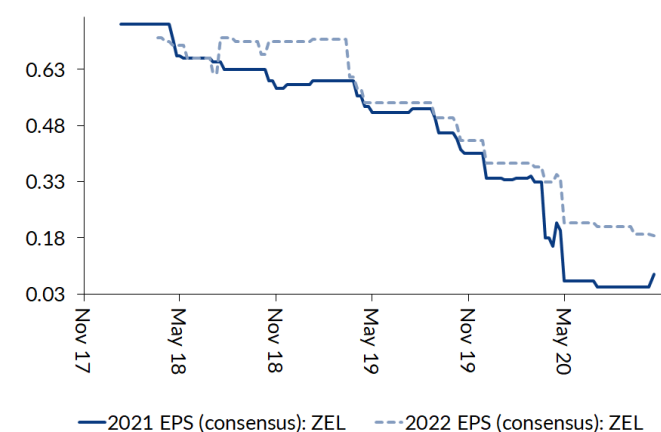
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

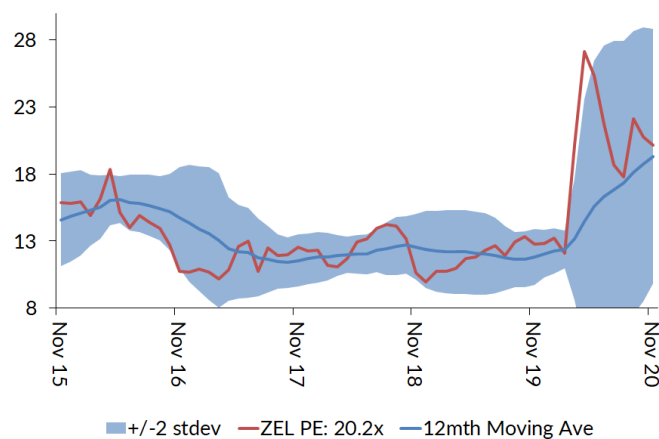
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect ZEL's balance date - March)										
Z Energy	ZEL NZ	NZ\$2.95	NZ\$1,534	>50x	14.9x	10.6x	8.2x	29.0x	14.8x	8.5%
SUBURBAN PROPANE PARTNERS LP	SPH US	US\$15.83	US\$984	17.2x	13.4x	9.2x	8.6x	18.4x	17.2x	7.6%
AMPOL	ALD AT	A\$25.88	A\$6,462	29.6x	17.0x	10.4x	8.4x	20.6x	13.6x	3.5%
VIVA ENERGY GROUP	VEA AT	A\$1.76	A\$2,860	>50x	20.9x	9.4x	6.9x	28.8x	15.6x	3.6%
CONTACT ENERGY *	CEN NZ	NZ\$7.53	NZ\$5,411	21.8x	25.7x	14.0x	15.7x	30.0x	36.4x	4.2%
MERCURY *	MCY NZ	NZ\$5.32	NZ\$7,247	28.3x	28.9x	17.0x	16.9x	30.1x	31.2x	3.2%
TRUSTPOWER *	TPW NZ	NZ\$7.11	NZ\$2,225	24.6x	24.7x	14.6x	14.7x	19.3x	19.4x	4.2%
MERIDIAN ENERGY *	MEL NZ	NZ\$5.50	NZ\$14,081	31.3x	35.7x	20.2x	22.8x	33.6x	41.0x	3.1%
GENESIS ENERGY *	GNE NZ	NZ\$3.06	NZ\$3,193	17.9x	16.9x	11.4x	11.7x	25.3x	27.8x	4.6%
Compco Average:				24.4x	22.9x	13.3x	13.2x	25.8x	25.3x	4.3%
ZEL Relative:				n/a	-35%	-20%	-38%	13%	-41%	99%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ZEL) 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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