NEW ZEALAND EQUITY RESEARCH | OIL & GAS | DOWNSTREAM FUEL RETAILER
29 APRIL 2020

Z Energy
Seeking Clarity — FY20 Result Preview

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

OUTPERFORM

Z Energy's (ZEL) FY20 result will be firmly focussed on the outlook, as the market seeks clarity around 1H21 and whether there will be an initial debt covenant breach. The uncertain outlook has already resulted in ZEL suspending its final FY20 dividend. The result itself should contain no surprises, with 4Q20 rescuing FY20 to some degree.

Figure 1. What we're expecting at the FY20 result: Reporting date Thursday 7 May

	FY20 Forsyth Barr	FY20 Bloomberg consensus	ZEL FY20 guidance
EBITDAF ($m)	362	367	355 to 365
Normalised NPAT ($m)	130	118	
EPS (cps)	32.4	29.5	
Final dividend (cps)	0.0	0.0	0.0
DPS (cps)	16.5	16.5	16.5

Source: Bloomberg, Forsyth Barr analysis Note: Market consensus is based on the median estimate.

NZX Code	ZEL
Share price	NZ$3.18
Target price	NZ$4.00
Risk rating	Medium
Issued shares	400.0m
Market cap	NZ$1,272m
Avg daily turnover	892.8k (NZ$4,604k)

Financials: Mar/	19A	20E	21E	22E
NPAT* (NZ$m)	195.8	129.7	37.7	133.5
EPS* (NZc)	49.0	32.4	9.4	33.4
EPS growth* (%)	-7.4	-33.8	-70.9	n/a
DPS (NZc)	43.0	16.5	20.0	30.0
Imputation (%)	100	100	100	100

*Based on normalised profits

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	4.6	5.8	9.2	6.0
EV/EBIT	6.4	9.8	22.6	9.7
PE	6.5	9.8	33.7	9.5
Price / NTA	5.0	36.6	11.0	7.5
Cash div yld (%)	13.5	5.2	6.3	9.4
Gross div yld (%)	18.8	7.2	8.7	13.1

Strong 4Q20, but no final dividend

After an awful 2Q20 and 3Q20, there was a material improvement in ZEL's fortunes in 4Q20 with retail competition easing slightly and the decline in oil prices providing a favourable finish to the year. However, that came to a shuddering halt in the final week of the financial year with the nation going into lockdown and fuel volumes falling ~-70%. ZEL has incurred/provided for $27m of costs in FY20, resulting in the guidance range of $355m to $365m. The uncertain 1H21 outlook has also led to ZEL shelving its final dividend.

Banking and trading update the key focus

There is unlikely to be any surprise out of the FY20 result itself. However, the market is firmly focussed on the 1H21 outlook and whether ZEL will be able to avoid making an initial debt covenant breach at 30 September 2020 (noting a formal breach only occurs after two consecutive reporting periods). Given the uncertain outlook, ZEL has been in discussions with its working capital facility providers and debt funders, and we expect any commentary around those discussions will be critical to the market reaction on the day. Any reassurance that the covenants are less likely to be breached (or that the debt holders are willing to waive or adjust the covenants) will be viewed favourably. In addition, ZEL will have had two weeks of trading under Alert Level 3 and the recovery in fuel demand volumes post-lockdown will also be an important metric for the market.

Don't expect FY21 guidance

Given all the uncertainty ahead of it, we do not expect ZEL to provide FY21 earnings or dividend guidance. Our FY21 EBITDAF forecast is $238m (median consensus $278m) and we assume no interim dividend, with a final dividend of 20cps (consensus 11.4cps).

FORSYTH BARR

Z Energy (ZEL)

Priced as at 29 Apr 2020 (NZ$)	**3.18**

12-month target price (NZ$)*	**4.00**
Expected share price return	25.8%
Net dividend yield	6.6%
Estimated 12-month return	32.3%

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

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	4,570.0	5,450.0	4,904.2	2,758.5	3,968.3
Normalised EBITDA	**448.0**	**435.0**	**362.5**	**237.7**	**361.9**
Depreciation and amortisation	(102.0)	(122.0)	(146.6)	(141.3)	(137.0)
Normalised EBIT	**347.0**	**312.0**	**214.9**	**96.4**	**224.9**
Net interest	(52.0)	(51.0)	(63.8)	(56.7)	(51.1)
Associate income	1.0	(1.0)	(1.0)	0	0
Tax	(82.0)	(61.0)	(40.0)	(11.1)	(48.7)
Minority interests	0	(2.0)	(18.6)	(9.2)	(8.3)
Normalised NPAT	**211.5**	**195.8**	**129.7**	**37.7**	**133.5**
Abnormals/other	(6.5)	(15.8)	(35.0)	0	0
Reported NPAT	**205.0**	**180.0**	**94.7**	**37.7**	**133.5**
Normalised EPS (cps)	52.9	49.0	32.4	9.4	33.4
DPS (cps)	32.3	43.0	16.5	20.0	30.0

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	18.3	19.3	-10.0	-43.8	43.9
EBITDA (%)	6.9	-2.9	-16.7	-34.4	52.3
EBIT (%)	3.3	-10.1	-31.1	-55.2	>100
Normalised NPAT (%)	8.2	-7.4	-33.8	-70.9	>100
Normalised EPS (%)	8.2	-7.4	-33.8	-70.9	>100
Ordinary DPS (%)	10.2	33.1	-61.6	21.2	50.0

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**448.0**	**435.0**	**362.5**	**237.7**	**361.9**
Working capital change	61.0	(159.0)	91.0	87.1	(69.7)
Interest & tax paid	(103.0)	(161.0)	(133.3)	(74.0)	(107.7)
Other	(15.0)	223.0	(192.0)	(4.0)	(4.0)
Operating cash flow	**391.0**	**338.0**	**128.2**	**246.8**	**180.6**
Capital expenditure	(87.0)	(55.0)	(87.7)	(45.0)	(45.4)
(Acquisitions)/divestments	18.0	(28.0)	36.0	0	0
Other	12.0	4.0	(27.0)	(28.0)	(28.0)
Funding available/(required)	**334.0**	**259.0**	**49.5**	**173.8**	**107.1**
Dividends paid	(134.0)	(152.0)	(198.0)	0	(120.0)
Equity raised/(returned)	(2.0)	(1.0)	0	0	0
(Increase)/decrease in net debt	**198.0**	**106.0**	**(148.5)**	**173.8**	**(12.9)**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	196.0	358.0	288.0	200.9	270.5
Fixed assets	870.0	830.0	805.8	779.7	754.5
Intangibles	750.0	668.0	785.3	733.0	684.6
Right of use asset	0	0	286.0	286.0	286.0
Other assets	134.0	161.0	219.0	219.0	219.0
Total funds employed	**1,950.0**	**2,017.0**	**2,384.1**	**2,218.6**	**2,214.7**
Net debt/(cash)	824.0	827.0	1,014.5	826.7	825.5
Lease liability	0	0	299.0	299.0	299.0
Other liabilities	269.0	270.0	250.5	244.3	236.4
Shareholder's funds	857.0	902.0	820.7	858.4	871.8
Minority interests	0	18.0	(0.6)	(9.8)	(18.1)
Total funding sources	**1,950.0**	**2,017.0**	**2,384.1**	**2,218.6**	**2,214.7**

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

Spot valuations (NZ$)	
1. DCF	3.97
2. Dividend Yield	3.79
3. Market Multiple	3.98

DCF valuation summary (NZ$m)	
Total firm value	2,860
(Net debt)/cash	(972)
Less: Capitalised operating leases	(299)
Value of equity	1,589

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	4.7	4.6	5.8	9.2	6.0
EV/EBIT (x)	6.0	6.4	9.8	22.6	9.7
PE (x)	6.0	6.5	9.8	33.7	9.5
Price/NTA (x)	11.9	5.0	36.6	11.0	7.5
Free cash flow yield (%)	23.9	22.2	3.2	15.9	10.6
Net dividend yield (%)	10.2	13.5	5.2	6.3	9.4
Gross dividend yield (%)	14.1	18.8	7.2	8.7	13.1

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	6.7	6.1	3.4	1.7	4.4
Interest cover EBITDA (x)	8.6	8.5	5.7	4.2	7.1
Net debt/ND+E (%)	57.2	55.4	63.4	57.0	56.5
Net debt/EBITDA (x)	1.8	1.9	2.8	3.5	2.3

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	12.4	11.0	7.1	3.4	7.7
Return on equity (%)	24.7	21.3	15.8	4.4	15.6
Return on funds employed (%)	17.4	15.8	9.8	4.8	11.1
EBITDA margin (%)	9.8	8.0	7.4	8.6	9.1
EBIT margin (%)	7.6	5.7	4.4	3.5	5.7
Capex to sales (%)	1.9	1.0	1.8	1.6	1.1
Capex to depreciation (%)	140	85	107	56	56
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	61	88	51	212	90

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Product volumes (m litres)					
Petrol	1,204	1,165	1,100	865	1,062
Diesel - retail	461	454	439	346	424
Diesel - commercial	807	812	791	678	759
Other fuels	1,153	1,193	1,137	410	808
Supply - domestic	520	544	543	455	528
Sub-total	**4,145**	**4,168**	**4,011**	**2,754**	**3,580**
Supply - industry & export	178	280	84	55	95
Total Fuels	**4,323**	**4,448**	**4,095**	**2,809**	**3,675**
Retail service stations	343	343	338	331	330
Petrol/service station (m litres)	3.72	3.61	3.42	2.70	3.32
Diesel/service station (m litres)	1.34	1.32	1.29	1.03	1.28
Gross profit (NZDm)					
Fuels	685	700	666	549	619
Refining	77	54	48	(28)	47
Non-fuels	76	81	79	55	73
Flick Electric	0	1	4	6	8
Gross profit	**838**	**836**	**796**	**583**	**747**
Fuels gross margin (cpl)	16.5	16.8	16.6	19.9	17.3
Fuels margin incl refining (cpl)	17.6	17.0	17.4	18.5	18.1
Fuels margin excl supply (cpl)	18.3	18.0	17.8	18.9	18.6
Non-fuels revenue/station (NZD 000)	373	398	389	274	363

2H20 / FY20 forecast

Figure 2. 2H20 / FY20 forecast

12 months to 31 March ($m)	2H19	2H20F	% Chg	FY19	FY20F	% Chg
Revenue	2,770	2,443	-12%	5,450	4,904	-10%
Gross Profit	**474**	**412**	**-13%**	**840**	**797**	**-5%**
Gross margin	17.1%	16.9%	-1%	15.4%	16.3%	5.5%
Operating costs	(214)	(233)	9%	(405)	(435)	7%
EBITDAF	**260**	**179**	**-31%**	**435**	**362**	**-17%**
Depreciation & amortisation	(65)	(55)	-16%	(122)	(129)	5%
EBIT	**195**	**125**	**-36%**	**313**	**234**	**-25%**
Net interest	(25)	(16)	-37%	(51)	(48)	-6%
Other	(19)	1		(22)	(35)	
Pre-tax profit	**151**	**110**	**-27%**	**240**	**151**	**-37%**
Tax expense	(44)	(21)	-52%	(61)	(40)	-34%
NPAT	**107**	**89**	**-17%**	**179**	**111**	**-38%**
Minority interest	2	19		2	19	
Normalised Profit	**122**	**73**	**-40%**	**196**	**130**	**-34%**
Earnings per share (cps)	30.4	18.2	-40%	49.0	32.4	-34%
Dividend (cps)	30.5	0.0	-100%	43.0	16.5	-62%
Key operating assumptions						
Volumes sold						
Petrol	605	548	-9%	1,165	1,100	-6%
Diesel - Retail	231	221	-4%	454	439	-3%
Diesel - Commercial	415	414	0%	812	791	-3%
Other	655	617	-6%	1,193	1,137	-5%
Supply - domestic	292	288	-1%	544	543	0%
Supply - industry & export	53	58	10%	280	84	-70%
Total fuel volumes (m litres)	**2,251**	**2,147**	**-5%**	**4,448**	**4,095**	**-8%**
Fuels gross margin (cpl) (excl export)	18.1c	16.8c	-7%	16.8c	16.6c	-1%
GM incl refining (cpl)	19.4c	17.6c	-9%	18.0c	17.8c	-1%

Source: Forsyth Barr analysis

Investment Summary

Our rating is OUTPERFORM. Z Energy (ZEL) is offering investors good value, with the market pricing in downside that we do not believe is likely to eventuate. Whilst there is a high degree of uncertainty in the current environment, ZEL is a strong business that we expect will come out of the COVID-19 crisis stronger than it went in.

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 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.

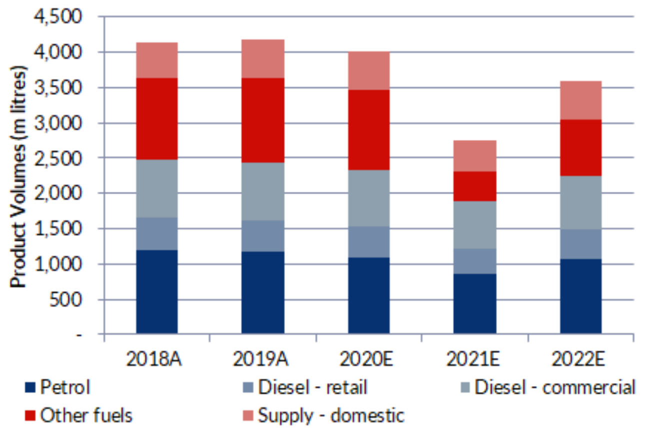
Financial structure

- **Dividend growth:** The COVID-19 crisis is likely to force the Board to reconsider its dividend policy. After a temporary dividend suspension, we expect dividends will resume at ~30cps.
- **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

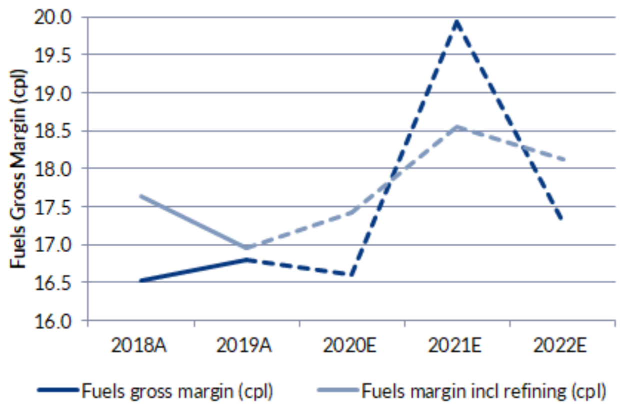
- **Long-term threat to industry volumes:** Increased vehicle efficiency and the threat from electric vehicles will pressure industry volumes. However, the near-term risks are low with industry volumes growing.
- **Retail Fuel Market Study (RFMS):** The RFMS has found that the retail fuel sector is over-earning 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 3. Fuel volumes



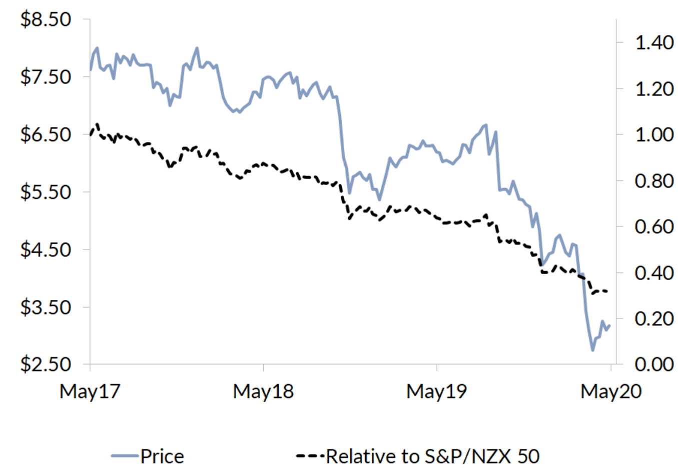
Source: ZEL, Forsyth Barr analysis

Figure 4. Gross margins



Source: ZEL, Forsyth Barr analysis

Figure 5. Price performance



Source: Eikon, Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
ACC	7.1%
Lazard	6.7%
Commonwealth Bank of Australia	6.1%

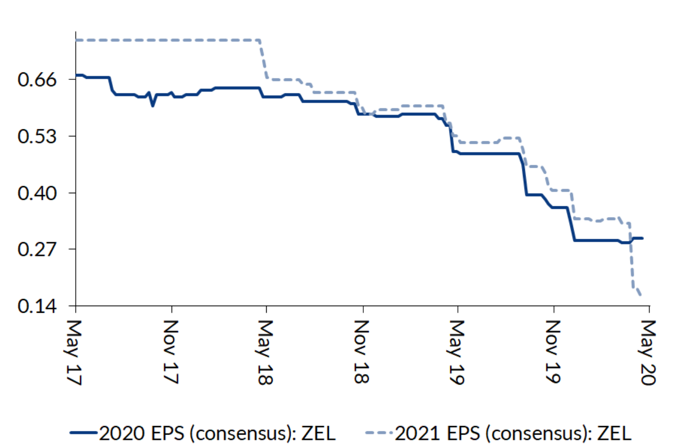
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect ZEL's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Z Energy	**ZEL NZ**	**NZ$3.18**	**NZ$1,272**	**9.8x**	**33.7x**	**5.8x**	**8.8x**	**9.8x**	**21.8x**	**6.3%**
SUBURBAN PROPANE PARTNERS LP	SPH US	US$14.88	US$924	15.1x	14.7x	9.0x	9.1x	16.0x	16.7x	14.6%
CALTEX AUSTRALIA	CTX AT	A$22.72	A$5,673	16.3x	18.5x	7.6x	7.9x	12.5x	13.7x	3.5%
VIVA ENERGY GROUP	VEA AT	A$1.35	A$2,625	>50x	>50x	10.0x	10.9x	31.2x	39.6x	3.0%
Contact Energy *	CEN NZ	NZ$6.30	NZ$4,524	18.6x	18.5x	11.9x	11.7x	22.4x	22.7x	6.2%
Mercury *	MCY NZ	NZ$4.59	NZ$6,246	26.4x	23.8x	14.6x	14.1x	24.6x	23.6x	3.5%
Trustpower *	TPW NZ	NZ$6.32	NZ$1,978	23.5x	19.7x	13.5x	12.2x	17.1x	15.1x	5.4%
Meridian Energy *	MEL NZ	NZ$4.82	NZ$12,354	24.9x	26.7x	16.1x	16.8x	24.9x	27.1x	4.5%
Genesis Energy *	GNE NZ	NZ$2.85	NZ$2,957	18.0x	15.8x	11.5x	10.7x	28.6x	26.0x	6.1%
			Compco Average:	**20.4x**	**19.7x**	**11.8x**	**11.7x**	**22.2x**	**23.1x**	**5.8%**
EV = Current Market Cap + Actual Net Debt			**ZEL Relative:**	**-52%**	**72%**	**-51%**	**-24%**	**-56%**	**-6%**	**8%**

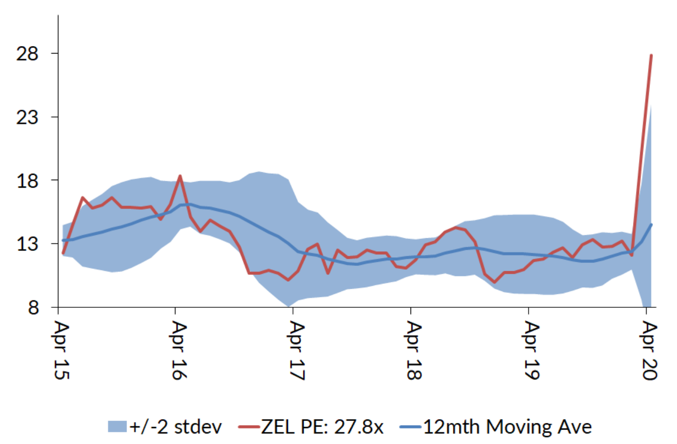
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ZEL) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ$)



Source: Eikon, Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Eikon, Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than $50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 28 Apr 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
42.0%	44.0%	14.0%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has within the past 12 months been engaged to provide investment banking services to the following issuers that are the subject of this publication: NZR

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.