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NEW ZEALAND EQUITY RESEARCH | OIL & GAS | DOWNSTREAM FUEL RETAILER
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Z Energy
Pumping in the Equity — FY20 Result

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Z Energy's (ZEL) FY20 result announcement was the supporting act to the equity raise announcement and cost out initiatives. ZEL is seeking to raise up to $350m, $290m from an Institutional Placement and $60m from a Share Purchase Plan. The equity raise is required to improve balance sheet metrics due to COVID-19 negatively impacting on operational performance. In addition to the equity raise, ZEL has indicated it is targeting to deliver $74m of opex saving in FY21 and will not be paying a dividend until 30 September 2021, at the earliest. The FY20 result was slightly ahead of expectations and ZEL latest guidance, but not materially so.

NZX Code	ZEL
Share price	NZ$3.14
Target price	n/a
Risk rating	Medium
Issued shares	400.0m
Market cap	NZ$1,256m
Avg daily turnover	766.9k (NZ$3,726k)

Financials: Mar/	20A	21E	22E	23E
NPAT* (NZ$m)	104.8	n/a	n/a	n/a
EPS* (NZc)	26.2	n/a	n/a	n/a
EPS growth* (%)	-46.5	n/a	n/a	n/a
DPS (NZc)	16.5	n/a	n/a	n/a
Imputation (%)	100	n/a	n/a	n/a
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
EV/EBITDA	5.9	n/a	n/a	n/a
EV/EBIT	10.6	n/a	n/a	n/a
PE	12.0	n/a	n/a	n/a
Price / NTA	n/a	n/a	n/a	n/a
Cash div yld (%)	5.3	n/a	n/a	n/a
Gross div yld (%)	7.3	n/a	n/a	n/a

Up to $350m equity raise announced one of three initiatives to deal with COVID-19 effects

COVID-19 has materially impacted ZEL operations, with retail fuel volumes down -80% vs. normal during the five-week Alert Level 4 lockdown period. This has placed pressure on ZEL's balance sheet, such that following discussions with its debt funding providers it is seeking to raise $350m of equity, with $180m being used immediately to repay bank debt. In addition, ZEL will not be paying a dividend until 30 September 2021, (1H22) at the earliest, having previously suspended its 2H20 dividend. The final step to address the challenging operational environment is to cut between $74m and $96m of operating costs from the business in FY21.

Cost out will help competitive position

ZEL had already been seeking to reduce costs following the challenging 2Q20 and 3Q20 period, with COVID-19 increasing the importance of reducing its cost base. $48m of the $74m to $96m opex saving is expected to be ongoing, increasing to $55m in FY22 as a full year of cost savings kick in. The remaining $26m cost savings (of the $74m) in FY21 are one-off in nature, with $18m coming from lower volumes. The $74m cost saving represents a ~-16% cut in underlying opex. If conditions are tougher than ZEL expects, it has identified a further $22m of one-off savings it can make at short-notice (taking the total savings to the top of the range, $96m).

FY20 result slightly better than guidance and our forecast

ZEL's FY20 EBITDAF result of $366m is slightly above its revised $355m to $365m guidance range. In addition, ZEL has increased COVID-19 related provisions +$6m to $33m, in effect taking the result +$7m above the top of its guidance range. Nevertheless, that is still -16% lower than the prior year due to challenging second and third quarters and weak refining conditions in 2H20. In addition, ZEL has taken a $61m write-off against its Caltex acquisition, taking the total FY20 asset write-off to $96m (following a $35m Flick Electric impairment in 1H20). ZEL has not provided any FY21 guidance given the current uncertain operating conditions.

Forsyth Barr Limited is a Co-Lead Manager of the Institutional Placement and Share Purchase Plan and will receive fees in connection with this role.

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Z Energy (ZEL)

Priced as at 11 May 2020 (NZ$)	**3.14**

12-month target price (NZ$)*	**n/a**
Expected share price return	n/a
Net dividend yield	n/a
Estimated 12-month return	n/a

Spot valuations (NZ$)	
1. DCF	n/a
2. Dividend Yield	n/a
3. Market Multiple	n/a

Key WACC assumptions	
Risk free rate	n/a
Equity beta	n/a
WACC	n/a
Terminal growth	n/a

DCF valuation summary (NZ$m)	
Total firm value	n/a
(Net debt)/cash	n/a
Less: Capitalised operating leases	n/a
Value of equity	n/a

Profit and Loss Account (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Sales revenue	5,450	4,987	n/a	n/a	n/a
Normalised EBITDA	**435**	**366**	**n/a**	**n/a**	**n/a**
Depreciation and amortisation	(122)	(163)	n/a	n/a	n/a
Normalised EBIT	**312**	**203**	**n/a**	**n/a**	**n/a**
Net interest	(51)	(66)	n/a	n/a	n/a
Associate income	(1)	0	n/a	n/a	n/a
Tax	(61)	13	n/a	n/a	n/a
Minority interests	(2)	(19)	n/a	n/a	n/a
Normalised NPAT	**196**	**105**	**n/a**	**n/a**	**n/a**
Abnormals/other	(16)	(42)	n/a	n/a	n/a
Reported NPAT	**180**	**63**	**n/a**	**n/a**	**n/a**
Normalised EPS (cps)	49.0	26.2	n/a	n/a	n/a
DPS (cps)	43.0	16.5	n/a	n/a	n/a

Valuation Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EV/EBITDA (x)	4.6	5.9	n/a	n/a	n/a
EV/EBIT (x)	6.4	10.6	n/a	n/a	n/a
PE (x)	6.4	12.0	n/a	n/a	n/a
Price/NTA (x)	5.0	n/a	n/a	n/a	n/a
Free cash flow yield (%)	22.5	17.0	n/a	n/a	n/a
Net dividend yield (%)	13.7	5.3	n/a	n/a	n/a
Gross dividend yield (%)	19.0	7.3	n/a	n/a	n/a

Capital Structure	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Interest cover EBIT (x)	6.1	3.1	n/a	n/a	n/a
Interest cover EBITDA (x)	8.5	5.5	n/a	n/a	n/a
Net debt/ND+E (%)	55.4	72.4	n/a	n/a	n/a
Net debt/EBITDA (x)	1.9	3.0	n/a	n/a	n/a

Growth Rates	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Revenue (%)	19.3	-8.5	n/a	n/a	n/a
EBITDA (%)	-2.9	-15.9	n/a	n/a	n/a
EBIT (%)	-10.1	-34.9	n/a	n/a	n/a
Normalised NPAT (%)	-7.4	-46.5	n/a	n/a	n/a
Normalised EPS (%)	-7.4	-46.5	n/a	n/a	n/a
Ordinary DPS (%)	33.1	-61.6	n/a	n/a	n/a

Key Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Return on assets (%)	11.0	6.7	n/a	n/a	n/a
Return on equity (%)	21.3	17.4	n/a	n/a	n/a
Return on funds employed (%)	15.8	13.2	n/a	n/a	n/a
EBITDA margin (%)	8.0	7.3	n/a	n/a	n/a
EBIT margin (%)	5.7	4.1	n/a	n/a	n/a
Capex to sales (%)	1.0	2.0	n/a	n/a	n/a
Capex to depreciation (%)	85	126	n/a	n/a	n/a
Imputation (%)	100	100	n/a	n/a	n/a
Pay-out ratio (%)	88	63	n/a	n/a	n/a

Cash Flow (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EBITDA	**435**	**366**	**n/a**	**n/a**	**n/a**
Working capital change	(159)	268	n/a	n/a	n/a
Interest & tax paid	(161)	(124)	n/a	n/a	n/a
Other	223	(194)	n/a	n/a	n/a
Operating cash flow	**338**	**316**	**n/a**	**n/a**	**n/a**
Capital expenditure	(55)	(102)	n/a	n/a	n/a
(Acquisitions)/divestments	(28)	21	n/a	n/a	n/a
Other	4	(29)	n/a	n/a	n/a
Funding available/(required)	**259**	**206**	**n/a**	**n/a**	**n/a**
Dividends paid	(152)	(203)	n/a	n/a	n/a
Equity raised/(returned)	(1)	0	n/a	n/a	n/a
(Increase)/decrease in net debt	**106**	**3**	**n/a**	**n/a**	**n/a**

Operating Performance	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Product volumes (m litres)					
Petrol	1,165	1,099	n/a	n/a	n/a
Diesel - retail	454	445	n/a	n/a	n/a
Diesel - commercial	812	769	n/a	n/a	n/a
Other fuels	1,193	1,120	n/a	n/a	n/a
Supply - domestic	544	537	n/a	n/a	n/a
Sub-total	**4,168**	**3,970**	**n/a**	**n/a**	**n/a**
Supply - industry & export	280	67	n/a	n/a	n/a
Total Fuels	**4,448**	**4,037**	**n/a**	**n/a**	**n/a**
Retail service stations	343	334	n/a	n/a	n/a
Petrol/service station (m litres)	3.60	3.41	n/a	n/a	n/a
Diesel/service station (m litres)	1.32	1.30	n/a	n/a	n/a
Gross profit (NZDm)					
Fuels	700	666	n/a	n/a	n/a
Refining	54	37	n/a	n/a	n/a
Non-fuels	81	76	n/a	n/a	n/a
Flick Electric	1	2	n/a	n/a	n/a
Gross profit	**836**	**781**	**n/a**	**n/a**	**n/a**
Fuels gross margin (cpl)	16.8	16.8	n/a	n/a	n/a
Fuels margin incl refining (cpl)	17.0	17.4	n/a	n/a	n/a
Fuels margin excl supply (cpl)	18.0	17.7	n/a	n/a	n/a
Non-fuels revenue/station (NZD 000)	397	373	n/a	n/a	n/a

Balance Sheet (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Working capital	358	119	n/a	n/a	n/a
Fixed assets	830	819	n/a	n/a	n/a
Intangibles	668	786	n/a	n/a	n/a
Right of use asset	0	282	n/a	n/a	n/a
Other assets	161	253	n/a	n/a	n/a
Total funds employed	**2,017**	**2,259**	**n/a**	**n/a**	**n/a**
Net debt/(cash)	827	1,083	n/a	n/a	n/a
Lease liability	0	299	n/a	n/a	n/a
Other liabilities	270	275	n/a	n/a	n/a
Shareholder's funds	902	600	n/a	n/a	n/a
Minority interests	18	2	n/a	n/a	n/a
Total funding sources	**2,017**	**2,259**	**n/a**	**n/a**	**n/a**

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

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Equity raise — key information

Figure 1. Equity raise details

	Equity placement	Share purchase plan (SPP)
Amount of equity raise	$290m	Up to $60m
Price	Minimum price of $2.75	Lower of placement price and a -2.5% discount to the 5-day volume-weighted average price up to SPP closing date
Underwritten	Yes	No
Record date	Friday, 8 May	Friday, 8 May
Timing	Completed Monday, 11 May (results announced Tuesday, 12 May)	Opens Friday, 15 May, closes Friday, 29 May
Uses of equity	1. The first $180m from the placement will be used to repay bank term debt 2. ZEL may use additional equity for the purposes of reducing covenant gross debt calculation, but such equity must then be applied to repay debt in due course	
Covenant changes	1. ZEL has received covenant relief from its banking syndicate and USPP noteholders for the 30 September 2020 and 31 March 2021 test dates 2. Retail bond covenant ratio increases +0.5x to 4.0x debt/EBITDAF for the 30 September 2020 and 31 March 2021 test dates	
Key covenant relief conditions	1. No dividends permitted until after 30 September 2021 (1H22) 2. Equity proceeds to fully repay bank facility ($180m)	

Source: ZEL, Forsyth Barr analysis

Summary of cost-out initiatives

Figure 2. Cost-out initiatives

	$m	Comment
FY20 reported opex	**416**	
less COVID-19 provisions	(24)	Provisions made for costs that expected to be incurred in FY21
less Flick costs	(11)	Adjusted to get to core ZEL opex
add "normal" bonus level	13	No staff bonuses have been paid in FY20
Underlying FY20 opex	**394**	
less "structural" savings	(48)	These savings are expected to be ongoing and increase to $55m in FY22
less "one-off" savings	(15)	$7m of the one-off cost savings relate to lower volumes
FY21 opex (base figure)	**331**	
less potential additional one-off savings	(22)	If required, ZEL has identified an additional $22m of cost savings
FY21 opex ("stressed business" scenario)	**309**	
One-off volume savings in cost of goods sold	(11)	

Source: ZEL, Forsyth Barr analysis

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FY20 result slightly ahead of expectations

Figure 3. FY20 result summary

12 months to 31 March ($m)	2H19	2H20	% Chg	FY19	FY20	% Chg	Forsyth Barr	$m Diff	Comments
Revenue	2,770	2,526	-9%	5,450	4,987	-8%	4,904	83	Higher excise taxes than forecast
Gross Profit	**474**	**397**	**-16%**	**840**	**782**	**-7%**	**797**	**(15)**	Commercial vols vs. f'cast down & some COVID costs in COGS
Gross margin	17.1%	15.7%	-8%	15.4%	15.7%	1.7%	16.3%	0	
Operating costs	(214)	(214)	0%	(405)	(416)	3%	(435)	19	Some COVID costs in COGS, but also savings started in 2H20
EBITDAF	**260**	**183**	**-30%**	**435**	**366**	**-16%**	**362**	**4**	Effectively $10m better than forecast due to +$6m increase in COVID-19 provision
Depreciation & amort.	(65)	(70)	8%	(122)	(144)	18%	(129)	(15)	Big lift in amort. from full year of Flick and digital investments
EBIT	**195**	**113**	**-42%**	**313**	**222**	**-29%**	**234**	**(12)**	
Net interest	(25)	(18)	-28%	(51)	(50)	-2%	(48)	(2)	
Other	(19)	(70)		(22)	(106)		(35)	(71)	2H $61m Caltex write-off, added to 1H $35m Flick write-off
Pre-tax profit	**151**	**25**	**-83%**	**240**	**66**	**-73%**	**151**	**(85)**	
Tax expense	(44)	32	-173%	(61)	13	-121%	(40)	53	
NPAT	**107**	**57**	**-47%**	**179**	**79**	**-56%**	**111**	**(32)**	
Minority interest	2	16		2	16		19	(3)	
Normalised Profit	**122**	**45**	**-63%**	**196**	**102**	**-48%**	**130**	**(27)**	
Earnings per share (cps)	30.4	11.3	-63%	49.0	25.6	-48%	32.4	(6.9)	
Dividend (cps)	**30.5**	**0.0**	**-100%**	**43.0**	**16.5**	**-62%**	**16.5**	**0.0**	No final dividend as previously guided
Key operating assumptions									
Volumes sold									
Petrol	605	547	-10%	1,165	1,099	-6%	1,100	(1)	Retail volumes in line with expectations, but big decline vs. pcp
Diesel - retail	231	227	-2%	454	445	-2%	439	6	
Diesel - commercial	415	392	-6%	812	769	-5%	791	(22)	ZEL impacted by significant forestry exposure
Jet/marine/ bitumen/other	655	600	-8%	1,193	1,120	-6%	1,137	(17)	Fall in jet and marine volumes in March more than forecast
Supply - domestic	292	282	-3%	544	537	-1%	543	(6)	
Supply - industry & export	53	41	-23%	280	67	-76%	84	(17)	
Total fuel volumes (m litre)	**2,251**	**2,089**	**-7%**	**4,448**	**4,037**	**-9%**	**4,095**		
Fuels gross margin (cpl)	18.1c	17.2c	-5%	16.8c	16.8c	0%	16.6c	0.2c	Margins in line with expectations. ZEL had a big 4Q20
GM incl refining (cpl)	19.4c	17.4c	-10%	18.0c	17.7c	-2%	17.8c	(0.1)c	

Source: Forsyth Barr analysis

Investment Summary

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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 severe demand declines to be relatively short-lived.

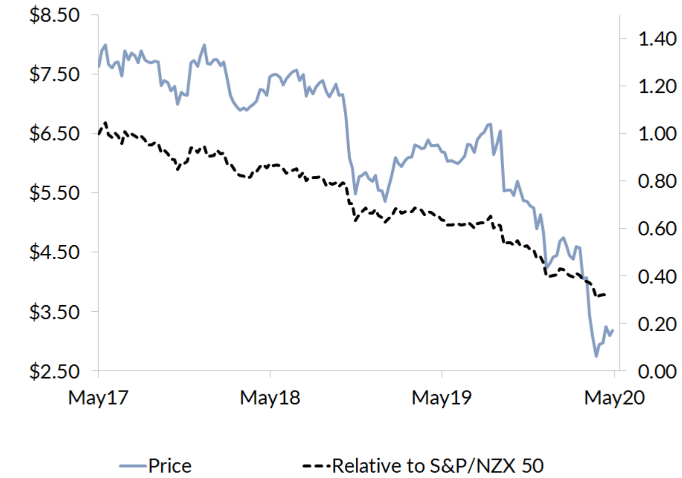
Financial structure

- **Equity raise:** Due to the negative financial implications from COVID-19, ZEL is seeking to raise up to $350m of equity, $290m from an Institutional Placement and up to $60m 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 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
ACC	8.1%
Lazard	6.7%
Commonwealth Bank of Australia	6.1%

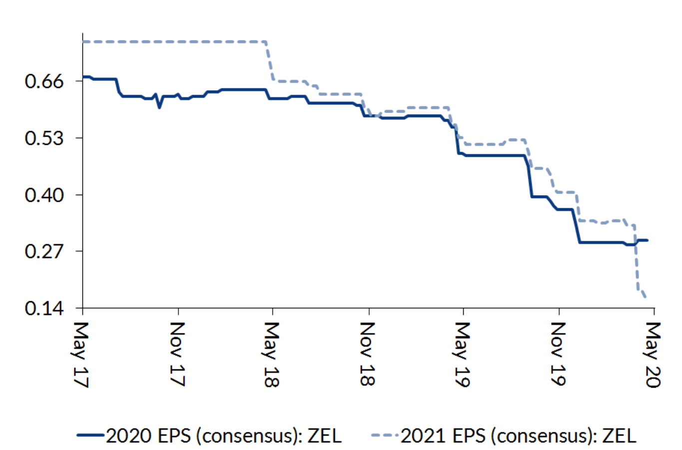
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. 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)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Z Energy	**ZEL NZ**	**NZ$3.14**	**NZ$1,256**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
SUBURBAN PROPANE PARTNERS LP	SPH US	US$14.88	US$924	14.7x	12.4x	9.1x	8.5x	16.7x	17.8x	15.5%
CALTEX AUSTRALIA	CTX AT	A$22.72	A$5,673	18.5x	12.4x	7.9x	6.2x	13.7x	9.4x	5.0%
VIVA ENERGY GROUP	VEA AT	A$1.35	A$2,625	>50x	12.6x	10.9x	7.1x	39.6x	13.3x	5.5%
Contact Energy *	CEN NZ	NZ$6.30	NZ$4,524	18.9x	18.2x	12.0x	11.6x	23.4x	22.9x	6.2%
Mercury *	MCY NZ	NZ$4.59	NZ$6,246	24.5x	22.7x	14.4x	13.7x	24.4x	22.7x	3.8%
Trustpower *	TPW NZ	NZ$6.32	NZ$1,978	23.6x	20.4x	13.6x	12.5x	17.2x	15.6x	5.4%
Meridian Energy *	MEL NZ	NZ$4.82	NZ$12,354	27.0x	27.4x	16.9x	17.0x	27.4x	27.4x	4.4%
Genesis Energy *	GNE NZ	NZ$2.85	NZ$2,957	16.0x	13.4x	10.7x	9.9x	26.5x	23.4x	6.2%
			Compco Average:	**20.5x**	**17.4x**	**11.9x**	**10.8x**	**23.6x**	**19.1x**	**6.5%**
EV = Current Market Cap + Actual Net Debt			**ZEL Relative:**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**

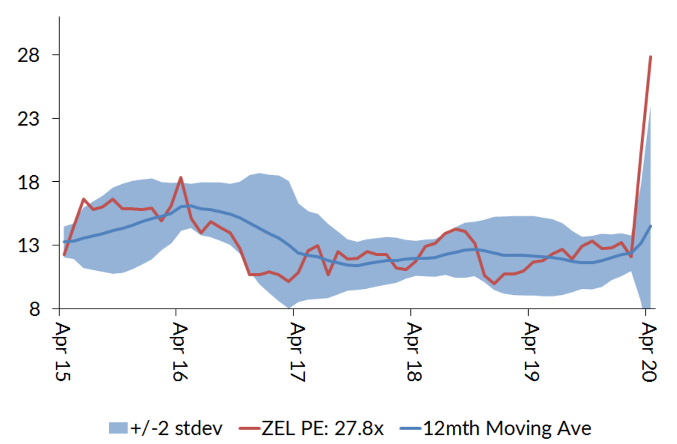
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ZEL) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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