

Z Energy

Pumping Up the Volume

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OUTPERFORM

Z Energy's (ZEL) October 2020 volumes show a continuing positive trend, in particular Caltex retail volumes, which for the first time in 2020 are ahead of 2019 volumes. Commercial diesel volumes also continue to perform well following a significant contract win in the middle of the year. In addition, the MBIE retail margin indicator and Singapore benchmark refining margins are holding or improving. ZEL has positive momentum at present, in stark contrast to much of the last three years. We reiterate our OUTPERFORM rating.

NZX Code	ZEL	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$3.12	NPAT* (NZ\$m)	102.2	22.0	103.2	125.5	PE	12.2	73.9	15.7	12.9
Target price	NZ\$4.35	EPS* (NZc)	25.6	4.2	19.8	24.1	EV/EBIT	12.4	27.2	12.7	10.9
Risk rating	Medium	EPS growth* (%)	-47.8	-83.5	n/a	21.7	EV/EBITDA	6.9	9.9	7.0	6.5
Issued shares	520.1m	DPS (NZc)	16.5	0.0	25.0	25.0	Price / NTA	n/a	5.3	4.1	3.9
Market cap	NZ\$1,623m	Imputation (%)	100	100	100	100	Cash div yld (%)	5.3	0.0	8.0	8.0
Avg daily turnover	1,206k (NZ\$3,931k)	*Based on normalised profits					Gross div yld (%)	7.3	0.0	11.1	11.1

Another positive volume month for ZEL

ZEL's total October 2020 retail volumes lifted +3.1% vs. October 2019, but within that Caltex branded volumes increased +3.9%. It is the first month in 2020 that Caltex volumes have exceeded those in 2019, which is a positive milestone given the loyalty scheme changes that took place in 2019 and the rebranding of three high volume Caltex sites to Z.

Commercial diesel volumes showed the greatest growth, up +10.5% vs. October 2019 following its successful Fletcher Building contract win in the middle of the year. However, other commercial volumes (in particular jet and marine fuel) continue to trend well below prior year volumes and are not expected to recover in FY21.

Retail margins holding up and even refining margins are off their lows

In addition to positive volume momentum, indications are that retail margins are stable and that refining margins are off the bottom (albeit still some distance from historic averages). The rolling four-week blended importer margin is 26.9cpl, +3.0cpl higher than the same time last year. More importantly, importer margins have been reasonably steady for much of the four months and do not have to increase for ZEL to hit FY21 EBITDAF guidance.

One of the headwinds ZEL has been facing for most of the past year has been low refining margins, requiring ZEL to top up Refining NZ's processing fees. The rolling four-week Singapore benchmark margin is US\$1.2/barrel, a marked improvement on -US\$1.4/barrel in June 2020, albeit still well below the historic 10-year average of US\$4.5/barrel. Whilst we expect the fee floor to remain in operation for the foreseeable future, any improvement in refining margins helps reduce the headwind ZEL faces.

On track for a positive re-rating

We maintain our positive stance on ZEL. ZEL still has work to do, but there is positive momentum in the business. Volumes are performing well, importer margins are holding up and there are even some positive signs in recent weeks that refining margins are off their floor of mid-2020. Barring another nationwide Level 3 or 4 lockdown, ZEL should deliver FY21 EBITDAF earnings within guidance. That in turn will enable ZEL to provide FY22 dividend guidance with a degree of confidence. We expect continued positive news flow will help unwind the significant discount the stock is currently trading on and reiterate our OUTPERFORM rating.

Z Energy (ZEL)

Priced as at 10 Nov 2020 (NZ\$)

3.12

12-month target price (NZ\$)*	4.35
Expected share price return	39.4%
Net dividend yield	5.3%
Estimated 12-month return	44.8%

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	3,133
(Net debt)/cash	(573)
Less: Capitalised operating leases	0
Value of equity	2,560

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)	5.4	6.9	9.9	7.0	6.5
EV/EBIT (x)	7.5	12.4	27.2	12.7	10.9
PE (x)	6.4	12.2	73.9	15.7	12.9
Price/NTA (x)	5.0	n/a	5.3	4.1	3.9
Free cash flow yield (%)	17.4	13.2	6.8	6.9	10.7
Net dividend yield (%)	13.8	5.3	0.0	8.0	8.0
Gross dividend yield (%)	19.1	7.3	0.0	11.1	11.1

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

ZEL monthly fuel volumes

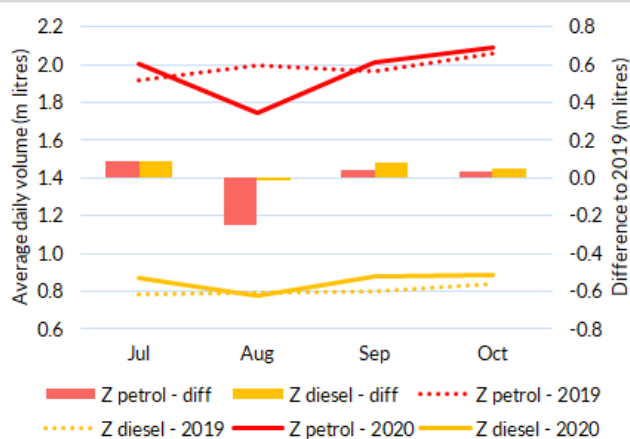
Figure 1. Monthly fuel volume movements

				% chg		Commentary
				% chg	vs. last	
m litres	Oct-19	Sep-20	Oct-20	vs. pcp	mth	
Volumes by brand/product						
Petrol - Z	64	60	65	2%	4%	Solid volume increase vs. Oct-19
Petrol - Caltex	28	26	28	1%	5%	Increase on September probably aided by holiday periods
Petrol - Domestic supply	12	11	11	-7%	-1%	Supply volumes can be lumpy, so no major concern
Diesel - Z	26	26	27	5%	1%	
Diesel - Caltex	12	12	13	10%	5%	Very strong diesel performance, usually a sign of SME
Diesel - Domestic supply	36	33	36	1%	5%	
Diesel - Commercial	66	70	73	10%	0%	Increase vs. pcp due to contract win
Other - Jet	71	22	26	-63%	15%	Improvement in jet vs. Sept a continuation of recent trends, but still well down on pcp
Other - Marine	20	1	2	-92%	4%	Marine continues to be very weak for Z
Other - Bitumen & other	19	10	16	-17%	44%	Big lift in bitumen
Total ZEL excl export	353	273	297	-16%	5%	
Terminal gate sales	0	13	12		-3%	
Industry & Export	21	1	5	-78%	211%	
Total ZEL	374	288	314	-16%	6%	

Source: ZEL, Forsyth Barr analysis

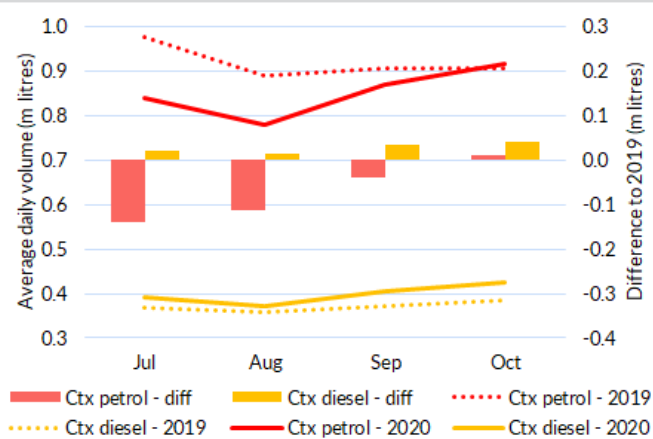
Note: monthly volume movement adjusted for the number of days in the month

Figure 2. Z branded sales volumes



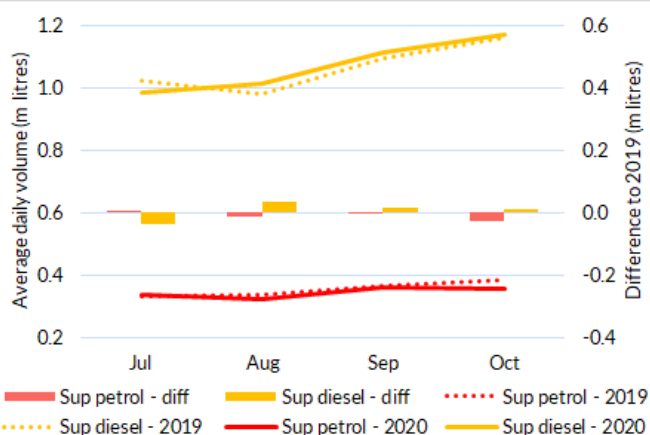
Source: ZEL, Forsyth Barr analysis

Figure 3. Caltex branded sales volumes



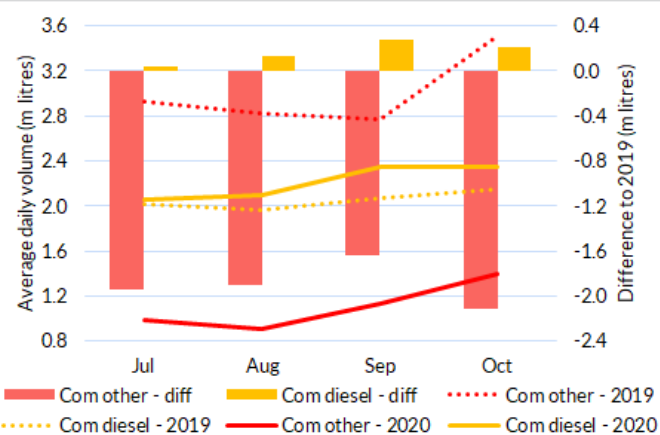
Source: ZEL, Forsyth Barr analysis

Figure 4. Domestic supply sales volumes



Source: ZEL, Forsyth Barr analysis

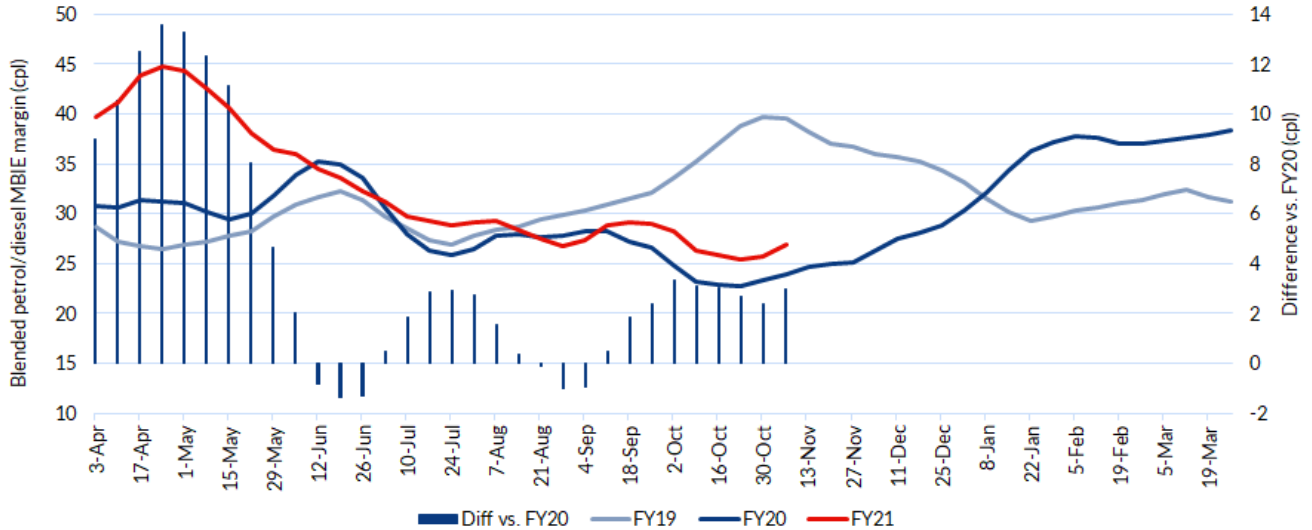
Figure 5. Commercial sales volumes



Source: ZEL, Forsyth Barr analysis

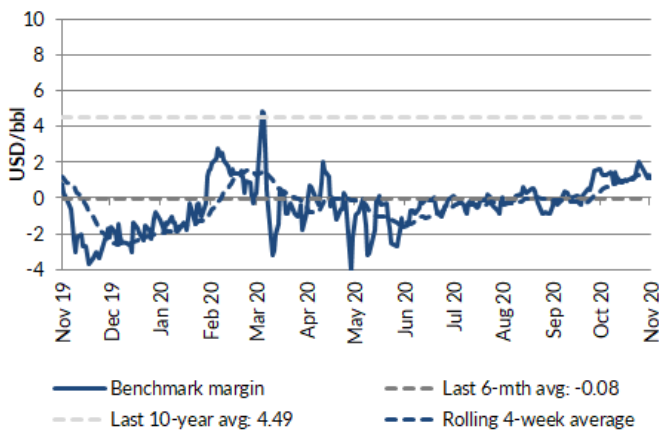
MBIE importer and Singapore benchmark refining margins

Figure 6. Blended rolling four week MBIE importer margin



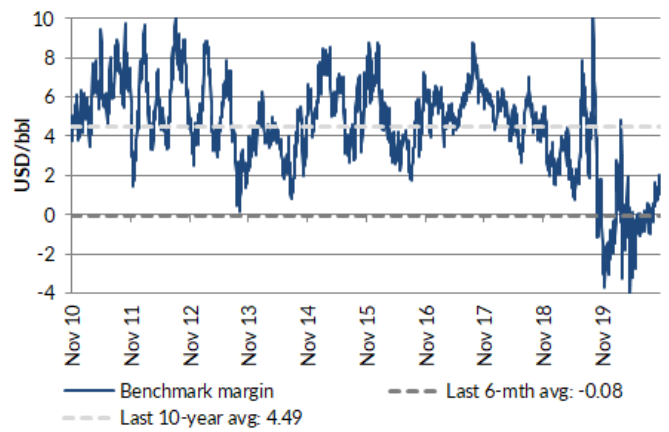
Source: MBIE, Forsyth Barr analysis

Figure 7. Singapore benchmark refining margin — last year

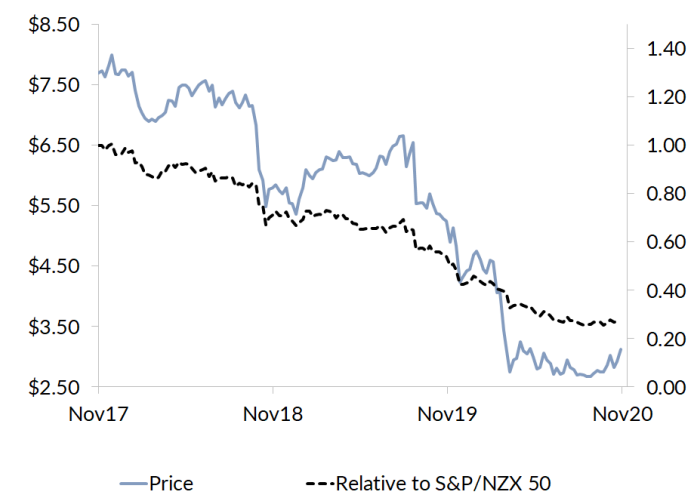


Source: Bloomberg, Forsyth Barr analysis

Figure 8. Singapore benchmark refining margin — last 10 years



Source: Bloomberg, Forsyth Barr analysis

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

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

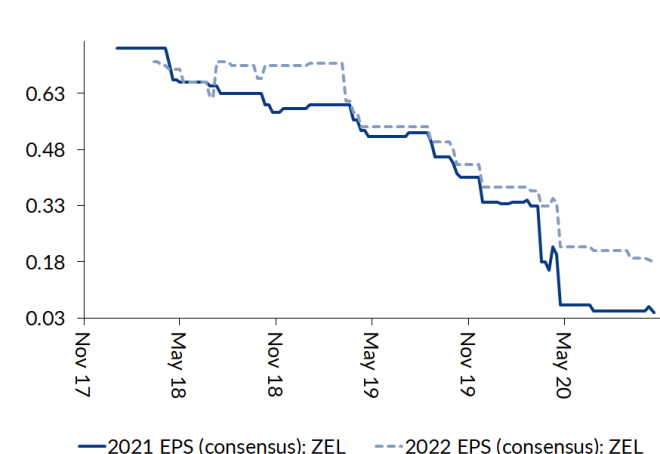
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 11. International valuation comparisons

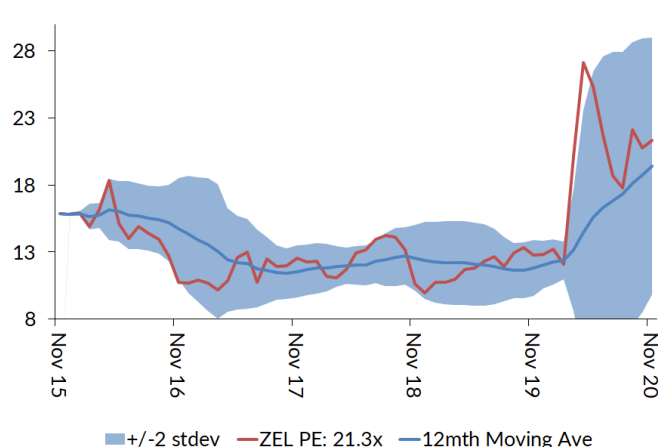
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect ZEL's balance date - March)										
Z Energy	ZEL NZ	NZ\$3.12	NZ\$1,623	>50x	15.7x	11.0x	8.4x	30.0x	15.3x	8.0%
SUBURBAN PROPANE PARTNERS LP	SPH US	US\$15.41	US\$958	16.7x	13.1x	9.1x	8.6x	18.2x	17.0x	7.8%
AMPOL	ALD AT	A\$26.23	A\$6,550	29.8x	17.1x	10.5x	8.5x	20.8x	13.8x	3.5%
VIVA ENERGY GROUP	VEA AT	A\$1.78	A\$2,884	>50x	21.5x	9.5x	6.9x	28.9x	15.6x	3.5%
CONTACT ENERGY *	CEN NZ	NZ\$7.90	NZ\$5,677	22.9x	26.9x	14.6x	16.3x	31.2x	37.9x	4.1%
MERCURY *	MCY NZ	NZ\$5.60	NZ\$7,622	29.8x	30.4x	17.7x	17.7x	31.4x	32.6x	3.0%
TRUSTPOWER *	TPW NZ	NZ\$7.40	NZ\$2,316	27.7x	29.1x	15.2x	15.5x	19.9x	20.5x	4.1%
MERIDIAN ENERGY *	MEL NZ	NZ\$5.81	NZ\$14,876	33.0x	37.7x	21.2x	23.9x	35.4x	43.0x	2.9%
GENESIS ENERGY *	GNE NZ	NZ\$3.14	NZ\$3,277	18.4x	17.3x	11.6x	11.9x	25.8x	28.3x	4.5%
Compco Average:				25.5x	24.1x	13.7x	13.6x	26.4x	26.1x	4.2%
ZEL Relative:				n/a	-35%	-20%	-38%	14%	-41%	92%

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 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Forsyth Barr analysis

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