29 April 2016

Focus on safety, customers following Commerce Commission clearance

Z Energy confirmed its focus would be on the safety and integrity of operations, and on serving customers, following the Commerce Commission's clearance today of its application to acquire 100 per cent of the shares of Chevron New Zealand (CNZ).

The Commerce Commission's announcement is available on its website at: www.comcom.govt.nz/the-commission/media-centre/media-releases/.

Z applied to the Commerce Commission for clearance to acquire CNZ (comprising CNZ's downstream operations in New Zealand, including CNZ owned service stations, supply contracts, terminals and its lubricants business) on 30 June 2015 for a purchase price of $785 million. Today the Commerce Commission cleared the transaction on the basis that, subject to Z's undertaking to divest certain assets, it would not be likely to substantially lessen competition in any market.

Z Chief Executive Mike Bennetts said while a robust 10-month investigation by the Commerce Commission had resulted in the transaction being approved, the creation of a larger company came with significant responsibilities for Z to its staff, customers of both companies, and to New Zealand as a whole.

"As a local company we believe buying the business of a global company is good for New Zealand and it's now up to us to prove it. We will start this journey as a new company exactly as we intend to continue - by ensuring our focus is squarely on the safety of our operations and on the customers and communities we serve."

A team of more than 100 people from both Z and CNZ have worked for almost a year on planning and technology solutions to bring the two companies together to enable them to operate as one from settlement, which is expected to be on 1 June 2016.

"Bringing two large companies with different technology, systems, processes and business models together is a complex and challenging undertaking. I want to thank the CNZ and Z teams for their commitment and professionalism in enabling us to get to this point. I look forward to welcoming the CNZ team to Z."

He said it was very much business as usual both before and after settlement for customers of both companies, who should notice no impact or change as a result of the way these teams had worked.

Cutover

Z said the next step would see the company focus on completing a safe and secure cutover of CNZ to Z's systems on 1 June 2016.

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"There is a substantial amount of work to be completed in order to fully integrate CNZ's business into Z's corporate structure and business operations. The technical systems cutover is scheduled to take place overnight on 31 May, with the 1 June settlement day being the first day the two companies will operate under common ownership."

Mike Bennetts said the company had been planning for the delivery of a safe and efficient cutover for the best part of a year, and he was confident the organisation has the structures in place to deliver that.

"In the period immediately following settlement and the cutover to Z's systems and processes, there will be an increased focus on the stabilisation of our operations, ensuring safety and continuity of supply for all of our customers."

Synergies
Once the acquisition is settled, Z said it is confident it remains on track to deliver the $25-30 million of synergies previously identified as a result of the deal.

Synergies are expected to be realised across improved supply chain efficiency, including at Refining NZ; reduced people costs, particularly through avoiding costs associated with the provision of offshore back office and support services to CNZ; and a range of IT, systems and process efficiencies.

"The expanded company will create value through leveraging the scale and scope of both companies' operations, including the diversity of business models and people expertise," Mike Bennetts said.

"We're confident in the identified synergies and once we have cutover to a single ERP system the next phase will be on integrating the two companies – this is where we expect to learn significantly more about the CNZ business, how it can most efficiently fit alongside Z's operations and where we may be able to generate additional value by learning from one another's experience and different business models."

Divestments
Mike Bennetts said as part of securing clearance Z has undertaken to divest certain assets over the coming months. These are:

- 19 retail service station businesses
- 1 truckstop business

"Z will need time to properly assess the financial impacts of these divestments given there are options as to which branded service station is divested. The volume impact on the combined company ranges between 60 – 80 million litres per annum. Over the past 11 months Z has had approaches from numerous parties expressing interest in any assets that may be divested so Z expects competition for these assets," he said.

Debra Blackett (Z's Company Secretary) has been appointed to manage the divestment workstream as a continuation of her accountability for leading the acquisition workstream, which included the Commerce Commission clearance process and the financing and legal activities required to be able to settle the transaction. Preliminary planning has already been completed which gives Z confidence it can meet its divestment obligations.

"It is quite common in acquisitions and was anticipated that we might need to undertake to divest some assets as part of securing clearance. Although we have not yet decided which specific assets will be divested and the consequent impact on earnings, we do not believe they materially diminish the attractive earnings multiples we bought at, the quality of the portfolio, or the target synergies. We are already working to ensure we carry out the divestments within the period we have undertaken to do so, with a significant focus on ensuring ongoing support for operations that might be impacted by a divestment decision," Mike Bennetts said.

People

Mike Bennetts reiterated that the skills and experiences of the CNZ team are highly valued and an important consideration in the acquisition.

"Z has committed that all CNZ staff will have at least 12 months of paid employment from the date of settlement. CNZ already runs a lean and highly efficient operation and we expect to learn a lot from their people over the coming months.

"There are obvious opportunities to reduce people costs in bringing the services that were provided to CNZ and charged in from a global services hub back into our existing operations.

"The CNZ team have conducted themselves with a high level of professionalism during an uncertain time and I'm very much looking forward to welcoming them into Z," he said.

Commitment to dual brand strategy

Mike Bennetts said Z remained committed to a dual brand strategy in the retail market.

"The operation of a dual brand strategy means our retail customers can continue to enjoy the different Caltex and Z branded service stations and the different offers that go with those stations and their different business models," he said.

Settlement and funding

The total purchase price is $785 million – plus a working capital adjustment - and will be funded from cash ($115 million) and debt ($670 million).

A $185 million pro rata equity raise was considered at the time of the announcement of the transaction. Given the passage of time - higher synergies and improvement in the underlying Z business over the FY16 year, partially offset by anticipated divestments - the

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decision has been taken not to raise additional capital and to instead fund the remainder through debt from pre-arranged debt facilities with Z's banking syndicate.

The funding mix will see Z's starting leverage on settlement of total debt to replacement cost operating EBITDAF earnings multiple of approximately 2.6x. Consistent with the 2 June 2015 announcement it is anticipated that leverage will reduce to ~2.0x within two to three years, albeit slightly slower given the higher opening debt.

"We appreciate the patience and support of our investors throughout the acquisition process and, think it is a better outcome to temporarily extend debt facilities rather than dilute existing equity holdings."

The transaction is expected to be settled on 1 June at which point Chevron will be paid the balance of the purchase price and the operation of the combined business will sit with Z.

Until settlement occurs, Z and Chevron remain competitors.

Guidance and market updates

Mike Bennetts said Z would be providing regular market updates on progress of the integration of the two companies post settlement and cutover.

"Our immediate focus will be on putting the two companies together, ensuring their safe and stable operation and then moving into the integration phase, during which we will start to understand more about the operation of the business and the value that an integrated company can generate.

"We acknowledge the strong interest in the cutover process and the complexity and risks that arise from putting two large business operations together. On that basis we will provide regular updates to confirm that these complexities and risks are being managed, and that customer satisfaction levels do not diminish.

"We will provide guidance for the standalone Z business with full year results on 12 May and in June will update that guidance to include the earnings contribution from the Chevron business," said Mike.

"Once we have been operating the business for several months we will host an investor day to update investors on the strategy for the integrated company and the financial forecasts that relate to that, probably in September or October this year."

Conclusion

Mike Bennetts said although the process of securing clearance had taken a long time, the real work in building a world-class company was now just beginning.

"As we become a larger and more strategically significant company we will have an increased responsibility to our customers, investors, staff and to New Zealand as a whole.

This is a responsibility we welcome and we are committed to building this company for the benefit of all our stakeholders in line with the values that underpin every aspect of our operation, as they have done so for all of the past six years," said Mike.

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