9 November 2017

Z delivers solid half year result, maintains full year guidance

Result and dividend
On a Historical Cost basis, Z Energy's net profit after tax for the six months to 30 September 2017 is $80 million, up from $73 million[i] in the prior comparable period (PCP).

On a non-GAAP Replacement Cost (RC) basis, which removes changes in the value of inventory from recorded profit, Z reported an Operating EBITDAF of $221 million, up from $186 million in the PCP, excluding $18 million of one-off transition expenses relating to the Caltex acquisition.

The six month period contains a full contribution from the Caltex business whereas the PCP contained four months.

The Z Board has declared an interim dividend of 10.4 cents per share, up from 9.4 cents per share in the prior half year. The interim dividend will be paid on 12 December 2017.

Z Chief Executive Mike Bennetts said he was pleased with the resilience of the Z business over the half year and the way in which all parts of the business have contributed to a solid financial result.

"We've seen softer contribution from the Retail business as retail margins appear to be at the top of cycle, while the Commercial business has improved both volumes and margins. Additionally, Z's strength across the supply chain has also contributed to the result due to greater economies of scale.

Guidance
Z's earnings guidance of $445-475 million for the full year remain unchanged.

Mike Bennetts said while Z's performance is historically slightly stronger in the second half of the financial year, there will also be some operational risks to manage.

Strategy: a more productive core business
During the period, Z started executing the company's third iteration of strategy – Strategy 3.0.

Following the successful integration of the Z and Caltex businesses in December 2016, Strategy 3.0 is designed to maximise the value from Z's new scale and presence across the supply chain. It is focused on delivering a more productive core business by shifting from being "asset" led to "capability" led.

"We believe the execution of Strategy 3.0 will deliver $35-40 million of additional earnings over the following three years, on top of the $40-42 million of synergy earnings which will be realised by the end of this financial year," said Mike.

Almost all of the earnings uplift will come from the Commercial and Supply and Distribution business units. Retail fuel margins are expected to contribute about 40 per cent of total earnings.

Rigorous approach to capital management
Following the debt and cash funding of the Caltex acquisition, debt leverage increased to 2.6x. A combination of earnings growth and debt repayment ($35 million was repaid in the half) has reduced leverage to 2.1x RC earnings at 30 September 2017 and Z is on track to reduce leverage to 2.0x by the end of FY18.

Mike Bennetts said Z had repaid debt rapidly and would reach 2.0 times debt to RC earnings ratio one year earlier than planned, enabling the introduction of a new distribution policy for shareholders.

"Following consultation with shareholders, we have decided once we achieve 2.0 times RC earnings to slow the pace of the company's debt repayments. We will continue to pay down debt but at a slower rate until we reach a 1.5x ratio. This is estimated to be by the end of the 2021 financial year.

"Continuing to pay down debt to this level demonstrates Z's commitment to prudent financial management. The programme will provide Z with a strong balance sheet and the flexibility to respond to either opportunities or threats."

Z's capital allocation will include a focus on releasing capital from less productive assets to fund planned growth capex. Where divestments exceed planned capex choices will be made to either repay additional debt, invest in the business or increase dividends. It is expected that integrity capex will be capped at $40 million per annum with any additional requirements funded through divestment.

Step-change in distribution policy
The accelerated deleveraging over the past two years has enabled Z to introduce a new dividend policy which will apply from the start of FY19.

Currently Z has been following a policy objective to increase dividends by 10 per cent per annum. From the start of FY19 this will be replaced by a commitment to pay as dividend 80 - 100 per cent of underlying free cash flows (defined as net cash inflow from operating activities less maintenance capex and principal debt repayments and adjusted for short term working capital fluctuations).

It is expected that this will see a material increase in dividends per share while also continuing to deleverage at about half the rate achieved since the Caltex acquisition.

Extended debt maturity profile with successful United States Private Placement
Subsequent to 30 September 2017, Z has successfully completed its inaugural United States Private Placement (USPP) with the issue of USD270 million of debt. This is in three equal tranches, and will be used to repay existing bank debt.

Settlement will occur in January 2018. The issue was at an average tenor of 10 years with the funding cost competitive to New Zealand domestic issuance. The USPP further diversifies Z's funding sources and significantly extends the average duration of debt.

MBIE process
Mike Bennetts acknowledged a high level of market interest in the political process around the NZIER Fuel Market Financial Performance Study.

Z most recently submitted to MBIE on 13 October responding to the two points of inquiry being the possibility of a borrow and loan registry and a more liquid wholesale market.

"Given Z's scale and asset base, and our continued concern around the way the industry currently remunerates fixed infrastructure assets, neither of these points cause Z significant concern. However, given New Zealand's fuel supply has become more and more efficient over the last 30 years, any changes would need to be very carefully considered in order to avoid unintended negative consequences."

Z has not yet discussed the intent regarding the future of this piece of work with the new Minister but looks forward to doing so shortly.

"Z remains confident it can demonstrate that the New Zealand downstream fuels industry has never been more competitive, with low barriers to entry and that returns are fair and reasonable."

An integrated company with a view to the future
Mike Bennetts said Z has now been an integrated company with the Caltex business for well over a year.

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“We are now in action executing a clear strategy to ensure a more productive core business and to realise significantly more value through changing the way we operate within the industry.

“We’re also ensuring we are well prepared for what the future might hold. Through Z’s ‘What is Next’ programme (WIN), our longer-term strategic options are being rigorously evaluated.”

Mike said Z has a competitively advantaged core business, committed and engaged people, and continues to build the company’s capability to win under changing circumstances.

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[i] *Z’s financial results for the period ended 30 September 2016 have been revised to reflect the finalisation of the acquisition accounting judgements relating to Z Energy 2015 Limited that were recorded as provisional at 30 September 2016.*

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