4 November 2020

Z first half results impacted by COVID-19 lockdowns and weak refining margins. Z responds with structural opex savings, a strengthened balance sheet and enhanced customer experiences to increase competitive position.

- **Half year result:** RC EBITDAF $95m, down 48% versus PCP.
- **Four point improvement plan:**
  - **Reduced costs:** On track to deliver $48m of annualised structural cost out. Full year FY22 run rate structural cost out expected to be $60m.
  - **Hold market share:** Focus on volume and enhanced customer experience (CX) delivering volume gains in competitive retail market.
  - **Monetise scale:** Fuel Industry Act passed; Z developing wholesale market to leverage terminal network scale ahead of Terminal Gate Pricing (TGP) introduction
  - **Manage capital:** $347m capital raise completed. Balance sheet strengthened and on track for resumption of distributions post 1HFY22
- COVID-19: **Lockdowns impacted total volume with Jet yet to recover. Retail and** C**ommercial** diesel **volumes** recovered **back to PCP levels. Employee engagement at all time high on back of focused internal response.**
- **Full year guidance:** Z reinstating full year earnings guidance; forecasting RC EBITADF for FY21 to be between $235m and $265m

First half FY21 results

Z Energy (NZX: ZEL ASX: ZEL) today announced its earnings for the six months to 30 September 2020.

Z Energy (Z) reports its earnings on an historic cost (HC) as well as a replacement cost (RC) basis. Statutory financial statements are reported on an historic cost basis in accordance with NZ IRFS, however replacement cost accounting is the globally used non-GAAP industry standard to measure financial performance.[1]

Historical cost net profit (loss) after tax (HC NPAT) was ($58m) for the first half of the year, down 307% from $28m in the prior corresponding period (PCP). This result was driven by the impacts of COVID-19 due to higher cost inventory sold at lower product prices and reduced volumes during lockdown with additional reduction in fuel demand for Jet fuel (-72% versus PCP) in particular. Lower than expected regional refining margins in 1H led to a reduction in refinery production and fee floor payments to Refining NZ were required, resulting in a net refining margin loss of ($14m).

Z reported replacement cost earnings before interest, depreciation, and amortisation (RC EBITDAF) of $95m, down 48% from $182m in the PCP. Z's replacement cost net profit (loss) after tax (RC NPAT) was ($19m), down 186% from $22m in the PCP.

Total marketing volume for 1HFY21 was 1,379 million litres, down 28% compared to the PCP, largely in Jet. On an RC NPAT basis, Z earned -1.38 cents per litre in 1HFY21 versus 1.15 cents per litre PCP.

[1] Z prepares its statutory financial statements on an historic cost basis in accordance with NZIFRS. Earnings prepared on this basis are subject to volatility due to changes in oil prices and exchange rates and is therefore not a dependable measure of business performance or profitability. Replacement cost earnings do not reflect this volatility to such an extent as the cost of the stock sold is accounted for as its replacement cost at the time of its sale. Z's management focuses on the industry standard replacement cost operating metrics, which it considers a better reflection of the underlying performance of the company.

RC fuel unit margin[2] of 17.6 cents per litre was up on the PCP of 16.3 cents per litre due to the mix shift to higher margin fuels during lockdown and lower Jet and Marine volume.

The capital raise of $347m was completed in June. The cash raised was used to pay down $180m of bank debt with net equity proceeds held to repay $150m of retail bonds coming due in November 2021.

COVID-19 impacts widely felt yet recovery faster than expected

For more than six months Z operated with a crisis team in place as the business dealt with the impacts and uncertainty of COVID-19.

“The resilience of our staff and our commercial partners during the country’s response to COVID-19 was excellent.” said Mike Bennetts, CEO of Z Energy. “The team has ensured security of supply to New Zealand under very difficult operating conditions. We have maintained safe and reliable operations while the business has delivered a materially different set of results, both operationally and financially, than was initially expected.

We remain alert to the potential of additional and ongoing COVID-19 outbreaks like that seen in August, but believe we are otherwise well placed to benefit from the economic recovery in domestic tourism and commercial activity driving volume and market share increases.” he added

Opex reduction and structural cost-out

Z is on track to achieve $48m in annual structural cost savings for FY21, in-line with guidance. The first half has realised $22m of structural opex reduction. Z expects the run rate full year impact of these changes to be $60m in FY22.

“The cost savings achieved not only help mitigate the financial impacts of COVID-19 this year but result in embedded efficiencies that will generate substantial, ongoing savings in future periods.” stated Lindis Jones, CFO of Z Energy.

Beyond the $22m of structural cost reductions Z achieved $14m of one-off cost reductions. This includes $3.4m of wage subsidy from the Government. Z applied for the wage subsidy only in the last week of the scheme to ensure it was needed and only after meeting all of the scheme’s requirements. Z has made only three COVID-related redundancies.

Commenting on the decision to apply for the subsidy, Mike said, “The application for the wage subsidy needs to be seen in the context of our financial results. First half operating profits were around half of what they were a year ago, despite costs being reduced by $35m. Prior to Z’s application for the wage subsidy Z had already cancelled $8m of employee bonuses and cancelled the FY20 final dividend, expected to be around $90m.”

Retail fuel market changes

The retail fuel market remains highly competitive. The industry continues to add capacity, albeit at a greatly reduced rate, with a net five new sites added in the second quarter of FY21. Z believes a combination of lower retail fuel margins and reduced COVID-19 related volume will see an acceleration of marginal sites closing.

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2 This is the margin on fuel sold before operating costs and corporate tax are accounted for.

Mike commented, “COVID-19 highlighted the importance of a contactless customer experience. We saw a volume shift towards Z as we were able to provide a range of safe and efficient solutions to meet our customers’ needs. We’ve seen increases in customer engagement and sales through our digital solutions such as Sharetank, Fastlane, and pre-order in-App purchases for coffee increased during the lockdown and have remained.

We know that loyalty remains a core value proposition. A year on from introducing Pumped as a unified offer across both the Z and Caltex brands, we’ve seen Caltex exceed last year’s volumes. In the first half we saw positive impact from changes to our loyalty offers with Flybuys and Air New Zealand Airpoints. Market share data availability has changed in light of the regulatory background but our data indicates that Z’s market share is increasing,” he added.

Refining margins

During 1HFY21 refining margins have continued to be at levels insufficient to cover the operational costs of domestic refining and coastal distribution. This has required Z to make $19m of fee floor payments to Refining NZ, leading to a net $14m refining margin loss for the period. RNZ operated in a ‘hot park’ mode with reduced capacity in response to reduced demand for product while the country was in lockdown.

Regulation changes

Z continues to implement the requirements of the Fuel Industry Act ahead of schedule, having nearly completed the soon to be mandatory display of premium product pricing on price boards throughout its retail network.

The wholesale market changes, including implementation of Terminal Gate Pricing (TGP), will open up competition in the wholesale market for which Z is well placed. The recent removal of the Nelson Terminal from the national network to operate under TGP has already seen positive results.

Z believes a shift to shorter tenure and non-exclusive distributor contracts will open up a more contestable wholesale market. The current Government timelines for implementing wholesale market changes and allowing distributors to exit existing agreements is however too long. We encourage the Government to accelerate the regulatory process allowing for more wholesale competition and achieving its goal of a more competitive retail market.

Full year outlook and reinstatement of earnings guidance

Z is re-instating its full year earnings guidance and is forecasting RC EBITDAF for FY21 to be between $235m and $265m.

In reintroducing full year earnings guidance Mike said, “We expect the second half of this financial year to be materially different to the first half. We’ve proven we’re operationally and financially resilient to all but the most extreme impacts of COVID-19. Our focus for the second half is cementing the structural costs savings already identified while we continue to vigorously compete in both retail and commercial markets.”

The guidance for the balance of the financial year assumes that New Zealand remains at Alert Level 1 and GRM remains at US$3/bbl requiring additional fee floor payments. Z is forecasting integrity capex of ~$50m for the full year and net zero growth capex.

As announced in May this year Z was granted a temporary waiver of key bank and debt covenants for the two test dates falling in September 2020 and March 2021. As part of obtaining these waivers Z was required to complete an equity raise and to not pay dividends until after 30 September 2021.

Following Z's successful capital raise the business has continued to perform above expectations as Alert Levels have not lasted as long, nor been as severe, as expected. Z anticipates shareholder distributions to resume after 1HFY22.

A presentation for media and investors will be held at 10.00am today, Thursday 4 November. A replay of the presentation will be available tomorrow on Z's investor website: https://investors.z.co.nz/announcements/webcasts-presentations

Reconciliation from statutory net profit after tax to RC net profit after tax

	Unaudited 6 months ended 30 September 2020 $m	Unaudited 6 months ended 30 September 2019 $m	Audited 12 months ended 31 March 2020 $m
Statutory net profit (loss) after tax	(58)	28	(88)
COSA	96	(18)	88
Net foreign exchange and commodity losses/(gains) on fuel purchases	(30)	7	68
Tax benefit on COSA	(27)	5	(24)
Replacement cost net profit after tax	(19)	22	44

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