17 June 2021

Z Energy CEO address to ASM

Kia ora koutou katoa. Welcome to Z Te Ware Rama and Abby thank you for those words.

Since we last met, a great deal has happened. The regulatory concern over our company and industry has been addressed and we are on the cusp of implementing the structure of the wholesale market that we have advocated for over the past three years.

With Z's support, the Fuel Industry Act came into effect last year with the first set of regulations taking force in just six weeks' time. The recommendations on these regulations are aligned with our own submissions and are consistent with Z generating commercial returns from our unrivalled national fuel terminal infrastructure. To put this into perspective, Z's market share is around 40% yet we own 54% of the terminal infrastructure. The current industry agreement, negotiated over 30 years ago, allowed one of our competitors to grow their business by selling our product from our tank to their own contracted Distributors without bearing the full cost of doing so. This is now changing, and we will be vigorously competing to supply Distributors as these contracts come to market.

We now have an agreement in principle with Refining NZ which moves us materially towards our preferred operating model: one in which all of our fuel products are imported, reducing complexity, volatility and cost in our business. I'll share some specifics on the next slide, but the key point is that by the time we have our next shareholders meeting, Z will operate as a different company: leaner, less complex, more resilient and with less earnings volatility and improved profits.

The Climate Change Commission has provided its Final Advice to Government and the first of its three emissions budgets. This was another source of uncertainty for Z's investors that has been removed. The Commission's forecasts fall within the two scenarios that Z was using for long-term planning, the Business Energy Council's Kea and Tui scenarios, that we have previously disclosed. At our upcoming investor day Z will share our long term forecasts that will aid investor's to forecast our future demand scenarios.

We also note that the Commission's Final Advice forecasts a slower rate of EV adoption and they have doubled the percentage of biofuels they expect to be used by 2035.

The Government has announced its intentions for a biofuels mandate, again aligned with Z's own recommendations. This will allow Z to reduce the carbon intensity of the products we sell and take advantage of the national liquid fuels infrastructure we have to support New Zealand's transition to a lower carbon future.

And beyond all of that, over FY21 we had Covid to deal with. This required us to face into financial, operational and even emotional issues that were well beyond business as usual. It was very challenging to come to work during those early weeks of lockdowns when sales were only 20% of normal, yet we still had to incur the fixed costs of running a business at 100% of sales. Our team did an outstanding job of changing operational practices throughout the various levels of lockdown. For example, our terminal staff were effectively border workers as we continued to unload imported fuel from ships that travelled here from Covid infected markets.

Z's site staff were amazing in how they worked with us to find ways to safely serve our customers, despite the increased aggravation they faced. Last year we recorded over 5,900 incidents of site staff abuse or onsite misdemeanours, a 75% increase on FY20. This pattern has been maintained in the first 10 weeks of this year. Z's corporate employees were asked to do more with less and we did operate with a sinking lid on employee numbers throughout the year. Notwithstanding these challenges, we finished the year with record employee engagement. We were also pleased that our financial performance improved from the dark days of 1Q's lockdowns to the extent that we were able to secure agreement from our debt funders to resume dividends six months sooner than what was announced when we undertook the equity raise.

Although we have an agreement in principle with Refining NZ, the move to an import terminal is still subject to its shareholders agreeing to a change in business model, and of course having all three of their customers reach a final agreement. All going well, Refining NZ's Board is expected to approve the transition in August which would see the import terminal operational sometime in 1Q FY23.

Strategically and operationally, we have been advocating for an import only supply chain for some time – for very good reasons. During FY19 and FY20, three of Z's earnings downgrades were related to the volatility of refining margins. Our reported refining margins in FY21 were -$21m, along with the costs of coastal shipping being an additional $24m. So being exposed to refining cost us at least $45m last year, or nearly 9 cents per share. That is the second year in a row of a loss-making refining activity compared to pure importing, and refining is not expected to recover sufficiently in the coming years.

The time to exit the crude oil supply chain has come. It is in the best interests of our company and our country.

This graph shows what the impacts are for this change, bridging off the actual results for FY21. Working from bottom to top, we would no longer have $21m of negative refining margins, would save immediately on one coastal ship at $11m, get freight and procurement benefits of $19m, and reduce Z employee costs by $2m.

The red bar you see there is a net figure that includes the RAP fees we paid plus the additional ITS fees netted off by the estimated cost recovery of the incremental ITS fees related to the Jet supply chain that we will seek to recover from our Aviation customers for the use of the terminal infrastructure. This sums to $36m more EBITDAF when compared to the FY21 base. In January 2023 we expect to cease the charter on the second coastal ship which would further reduce costs by $13m. Put simply, if Z had exited the refining business and been operating under this import terminal model for FY21, our EBITDAF would have been $49m higher than the reported $237m.

There may well be further upsides to the procurement benefits but we will not know that until we actually tender our business early in third quarter of this financial year. We do know our fuel imports are going up threefold, we just don't know how much lower our costs could be as a result of this scaling up.

Exiting refining also enables us to reduce our inventory, effectively no longer holding around two million barrels of crude oil at Marsden Point or in transit on the water. Depending on the crude price when we exit refining, this will release around $150m of cash that is no longer required for inventory. This will not compromise New Zealand's supply security and we have been able to assure the Government of that.

Like you, I am a shareholder, so I'm not happy about the decline in profitability over the past three years when our EBITDAF peaked at $449m in FY18 to fall to $237m in FY21. $98m of the decline is explained by refining margins, and the move to an import terminal will take away that risk and deliver more cash. $77m is the impact on sales from Covid-19 and we expect that to mostly recover in FY22 other than Jet which makes a very small contribution to profits. The $87m of lower retail unit margins was partially offset by $69m of cost savings with some additional offset in convenience retail. Two of these three downsides were happening before Covid-19 which is why we developed our four point improvement plan six months before Covid-19 impacted New Zealand.

In terms of Reduce Costs, our employee and contractor headcount is down 20% from a December 2019 high. Most of this is off the back of completing large IT projects, which means we have the foundational technology we need to compete and lower costs, and we do not need to spend as much on this for the foreseeable future. Our other cost reductions are not simply squeezing the lemon, because those costs come back once better times turn up. Instead, we will continue to make strategic decisions on how we choose to compete, or not. For example, we exited the marine fuel oil barge in Auckland and no longer pay $6m of charter fees. We withdrew our forecourt concierge offer, saving $10m a year, knowing that many customers no longer value that offer and, for those that do, we can find workarounds to meet their needs.

The FY21 operating cost savings of $48m run rates through FY22 to be $70m of structural cost reductions compared to what we spent in FY20.

Exiting the crude oil supply chain enables us to consider further options to simplify our business and further reduce costs. Some of this will be related to business activity that becomes discretionary, and where assets or earnings are better owned by others. We are mostly through this analysis and will share the specific choices and the size of the prize at Investor Day.

In terms of Hold Market Share, we have flattened the year-on-year declines we have seen for some time across both of our brands. That has been at the expense of margin, but we are very clear about our strategy here.

Firstly, we price to be competitive within a site's neighbourhood and/or traffic flows. That means using our Z Business card or Pumped offer (with Flybuys or Airpoints) will give you a lower price than any neighbouring unmanned site. Second, we use digital technologies to lower costs. That means we will save $10m a year from withdrawing the forecourt concierge, and this is already in the $70m of FY22 cost savings, because we now see over 40% of our customers choosing to use pay in App, Pay by Plate or Pay at Pump to provide easy and seamless digital transactions. Third, we will only develop customer experiences where the returns on that investment are worth it, and they demonstrably improve our customer experience.

There is undoubtedly financial stress within our industry. The two globally integrated Oil majors that we compete with here in New Zealand recently reported historic cost losses for their last financial year. We see sites of all brands reducing operating hours and maintenance spend and taking away service from the forecourt to reduce labour costs. The net number of new sites to the industry was 5 in 2020, down from 21 in 2017 and there was only half the number of new sites opened in 2020 compared to 2018.

We are surprised that more sites are not closing, especially given we have closed 2 retail sites and one truck stop in the past year as well as converting three Caltex sites to Z. That said, our Z sites are more resilient to this financial stress because of our scale, the operating model with our Retailers, and our non-fuel income which is the equivalent of seven cents per litre – something that an unmanned service station does not get. We are currently building our next generation store inside a warehouse so we can understand how we would operationalise our design and growth ideas. This is not about a massive change in store format; rather much more focused on improving sales capacity and product mix within our current footprints. We will share more specifics at our investor day, and we currently anticipate an uplift in EBITDAF off the FY21 base of $20-30m by the end FY24.

In terms of how Z will Monetise Scale, the changing regulatory environment is consistent with this. I repeat, Z's market share is 40% yet we own 54% of the terminal infrastructure. The current industry agreement was designed and agreed over 30 years ago when four Oil majors each had around 25% of the market for both retail fuel and industry storage – it is vulnerable to free-riding by competitors that are under-invested compared with their market share. In the past year we have removed two terminals, representing almost one-third of our storage volume, from the industry agreement and we are now receiving commercial returns from these terminals. Commercial returns for our terminals and direct supply to Distributors would improve earnings in the range of $10-15m per annum off a FY21 base.

It is also useful to remember that many of our fossil fuel assets can accommodate or be re-purposed for lower carbon fuels. Biofuels will use the same supply and distribution infrastructure. Hydrogen for trucks, most likely after 2025, can be distributed through our existing truckstop network, which is twice the size of our nearest competitor's. Our very well located service stations will be able to have EV charging units, as we already do at 9 of our sites. You have heard from the government in recent days that no more than 75kms should separate EV charging points to help Kiwis alleviate EV range anxiety. Basically, we have more tanks, pipes, service stations and truckstops than any other competitor so will do much better than others as New Zealand transitions away from fossil fuels.

In terms of manage capital, I remind you of our Investment Thesis: Z will cap hydrocarbon (fossil fuel) assets to under $2 billion, we only invest in core business projects where discounted paybacks are less than five years, we will reduce leverage to a level commensurate with the long-term outlook for our core business, and we will pay a sustainable dividend.

At our Investor Day on [28 July], we will outline our plans for allocating the substantial cash that is available over the next three financial years – cash from operations, exiting refining and asset divestments.

We will confirm our leverage target and Distribution Policy – how our returns to shareholders will be made across sustainable ordinary dividends with top-ups from special dividends and buybacks to reward shareholders. For debt, we have $150m set aside for our Retail bond maturing in November this year, and we will use the working capital release from exiting refining to repay the $70m of debt falling due in 2023 and $125m in 2024. This has the effect of reducing our gross debt, including long term leases from IFRS16, to $677m from $1.2 billion at the end of FY20. Taking consensus forecasts for RC EBITDAF, by the end FY24 this would have our leverage at 1.96x, under the current 2.0x target. All achieved without compromising or constraining a sustainable dividend. Shareholders should consider the 19cps bottom end of current guidance to be reliable under almost any foreseeable circumstances.

If I was allowed to make a fifth point on a four point plan, I would comment on how important it is that we run safe and reliable operations, and thank the Z team for our outstanding performance in this area over the last 18 months. In a year where Covid caused multiple changes and increased operational complexity, almost all of our safety and wellbeing metrics were ahead of the previous year's, we had a record fuel delivery performance and our supply chain reliability ensured families and businesses didn't have any more stress and upset than that which they were already dealing with. Our people know how important this is as 76% of them score 9 or 10 out of 10 in response to the statement – 'Z never compromises the safety and wellbeing of its people or the environment in order to meet its objectives'.

At our investor day we will share with you plans for further optimising the core business (with growth in EBITDAF that does not rely on margin expansion), long-term demand forecasts given the Climate Change Commission's budgets, and Z's plans to transition to a low carbon future and the resulting capital management.

Our investor day will not be webcast but it will be recorded and available for playback, along with the presentation materials, from Z's investor centre.

In setting up for FY22, our four point plan keeps us focused. We have learnt from the past - the good and the bad - and improved how we execute. At one level it is how we work by moving to Z's version of Agile. In other cases, it is getting members of the executive team playing in their best position, or recruiting across the business where we are short of the skills needed to deliver excellent customer experiences. We recognise the risk and opportunity with the move to stop refining and move to an import terminal, as we all scale up for the biofuels mandate. We have a general manager solely focused on that in FY22 to ensure the cash flows reliably from those changes.

My experience tells me that this current financial year will throw something our way that we didn't expect – it may be good news for a change, but we are prepared if it is bad news. If anything, we are in better shape to deal with the unexpected and to do a better job of delivering cash from the expected.

I know this last year has tested the patience of our shareholders. It has been a tough, challenging year for all of us. But we have used this year to strengthen out foundations and prepare to return genuine value to our shareholders over the coming years.

Our company has weathered these challenges and come through it in better shape than ever to reward you for your continued trust and confidence.

Thank you very much again for your support. I will now hand back to Abby.