7 November 2013

Half Year earnings consistent with IPO guidance

Result and dividend

Z Energy today posted its first result as a listed company, delivering earnings and net profit for the six months to 30 September 2013, slightly ahead of the company's plan.

On an historic cost (NZ IFRS) basis, Z's statutory reported Net Profit After Tax (NPAT) for the six months ended 30 September 2013 was $55.5 million, up from $24.9 million for the previous corresponding period.[1]

On a pro forma replacement cost basis, Z posted Earnings Before Interest, Taxation, Depreciation (including gains and losses on the disposal of fixed assets), Amortisation and Fair Value movements on interest rate derivatives (RC EBITDAF) of NZ$107 million, up from $100 million for the prior corresponding period.[2, 3]

As indicated at the time of the IPO, Z's policy is to pay dividends of 80 per cent of full year replacement cost NPAT (subject to performance and other relevant factors). As forecast at that time, the Z Energy Board has decided to pay a fully imputed cash interim dividend to shareholders of 7.7 cents per share, representing approximately 35 per cent of the total forecast full year dividend. The balance is expected to be paid in May or June 2014.

The record date for the interim dividend will be 22 November, with dividends paid on 4 December.

Consistency of earnings through volume / margin management

Chief Executive Mike Bennetts said this was a pleasing result, particularly in that Z had demonstrated the ability to respond to a range of market conditions and deliver consistency of replacement cost earnings.

"Over the period we saw crude oil prices range between US$103 and US$111 per barrel and in the month of September domestic pump prices hit the highest ever mark in New Zealand on the back of rising international prices."

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1 Z's statutory earnings are prepared on an historic cost basis (as required by NZIFRS). Earnings prepared on this basis are subject to fluctuations in the value and volume of stock held over the period, due to changes in oil prices, exchange rates and deliveries. Z's replacement cost earnings do not reflect fluctuations to any material extent, as the cost of the stock sold is treated as its replacement cost at the time of its sale. For 1HFY14 the replacement cost approach to valuing stock has resulted in an increase in cost of stock of $3 million. This is not reflected in Z's statutory earnings.

2 Z's management focuses on (and Z provides guidance on) replacement cost operating earnings, which Z considers better reflect the underlying trading performance of the business. More information about replacement cost accounting and the difference between replacement cost and historic cost earnings is provided at the end of this announcement and in the accompanying presentation pack.

3 Pro forma results are presented on the same basis as the IPO prospectus – i.e. as if the listing and all of the associated transactions occurred on 1 April for each reporting period. See page 126 of the IPO Offer Document and the accompanying presentation pack for more information.

3 Queens Wharf
PO Box 2091
Wellington 6140
New Zealand

0800 474 355
z.co.nz

"While volumes have been softer than expected at least partially as a result of record fuel prices, this has been balanced by a sustainable approach to margin management and maintaining the integrity of the company's supply chain through choosing where to place volume," he said.

"We have always said Z will target an optimal mix between volume and margin and that market share is not a target in itself. This result demonstrates why this approach is so fundamental to Z's consistency and quality of performance – market share only matters at the right margin."

On a replacement cost basis, Z's total gross margin[4] over the period was $245 million, up from $236 million for the prior comparable period. The growth was delivered by a combination of increased fuel margins, store margins growing through recent upgrades, and slightly higher refining margins above the prior comparable period. Once all operating expenses have been met, Z's pro forma replacement cost net profit after tax was 4.2 cents per litre, up from 3.7 cents per litre in the prior period.

"Over the last three years we have seen much needed improvement in fuel margins which are enabling the industry to begin to invest after years of continual cost cutting, while still delivering competitive prices and value to customers," said Mike.

"Z remains a high fixed cost, low margin business. Over the last 12 months we have made progress in terms of giving up particularly low margin or unprofitable commercial accounts, securing the optimal mix of retail volumes and we are focused on securing commercial accounts that deliver a fair return and cover the cost of capital tied up in supply."

Strategy update

Mike Bennetts said Z is coming to the end of the company's first three year strategy, which will soon be superseded by the next three to five year program.

"The choices we've made, the performance we've delivered and the way we have run the business have been driven by our strategy. Our first strategy program has established Z as a stand-alone local company and delivered sustained growth through strategic investment and focused operational management.

"Over the past few months Z's management and the Board have been developing the next phase of Z's strategy which will be squarely focused on delivering the next program to grow Z's earnings.

"Z's new strategy will take the company through the next three to five year period and the projects and initiatives contained within it will be reflected in guidance for the next full financial year."

[4] There has been a presentational change whereby realised and unrealised gains and losses are no longer included within purchases, instead they are shown as a separate line within operating costs.

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Growth initiatives

Within the existing strategy, Z remains committed to delivering growth through capital investment and focused operational management.

"Over the next six months we expect to build an additional five new-to-industry retail service stations, taking the total for the financial year to six. These will be followed by five more in the 2014 financial year and another seven to eight over the following three years."

Mike Bennetts said ideally the company would have liked to have been three months ahead on its new service station build programme as it has taken slightly longer than planned to build the in-house capability to manage the programme and secure the necessary council consents.

"These new sites will be strategically placed to deliver growth in earnings through increased fuel volume and store sales."

Mike said the refit of Z's top 100 retail service station stores was completed in August, with refitted stores showing 12 per cent year on year growth in sales. Decisions would be made for the next phase of the Z strategy as to the format and level of investment appropriate for the company's remaining retail sites.

"Additionally, we are currently working to deliver growth through Z's commercial channel and fuel supply chain. We're working to determine how greater efficiency in terms of our dual supply chain can deliver better financial results and operational efficiencies, as well as ways to improve Z's import freight and transport economics," said Mike.

"We have successfully completed a selective RFP process for the supply of refined fuels at terms that reflect further cost savings and are consistent with the forecasts contained in the IPO Prospectus. We are currently in the final stages of contracting and will soon make a full announcement on the completion of this contract."

Brand

Mike Bennetts said two and a half years after the launch of the Z brand, Z's monthly brand tracking has seen Z firmly establish its position as the most preferred retail brand in the downstream transport fuels market, which provides a strong platform upon which to continue to build customer loyalty.

Safety

Mike Bennetts said Z continued to focus on reducing operational risk and building towards becoming a Zero Harm organisation.

"Safety is the foundation upon which our business is built and we continue to invest time, resource and expertise right across the business into continually improving our health and safety performance. The six months to 30 September represented good performance on health and safety, with investment occurring in new systems and reporting processes to ensure continued visibility around ways to improve health and safety outcomes."

3 Queens Wharf
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z.co.nz

Initial public offer

Mike Bennetts said Z had settled well into life as a listed company and, while the process had been a five month period of distraction for management, Z was squarely focused on delivering shareholder value.

“We were very pleased with investors’ response to the Z listing both in terms of initial demand for the stock and in the secondary market. We now have a high quality register with a balance between two cornerstone shareholders, local retail investors and experienced long-term domestic and international shareholders.”

Outlook and guidance

Mike Bennetts reaffirmed the guidance provided in the IPO prospectus, of full year replacement cost EBITDAF of $205 - 215 million. He said that given the current circumstances, Z expects the final dividend payment to be in accordance with the company’s dividend policy and in-line with the IPO Prospectus forecasts.

Jonathan Hill: 04 498 0212

3 Queens Wharf
PO Box 2091
Wellington 6140
New Zealand

0800 474 355
z.co.nz

Reconciliation from statutory NPAT to Pro Forma EBITDAF (replacement cost)

Net Profit per the statutory accounts	**56**
Share of earnings in RNZ from 1 April to 18 August	4
Net financing expense from 1 April to 4 July	(8)
Replacement cost of sales adjustment (COSA), net of tax	(2)
Taxation	1
Pro Forma RC net profit after tax	**51**
Depreciation and amortisation	17
Net financing expense	17
Other	2
Taxation (including tax on COSA)	20
Pro Forma RC EBITDAF	**107**

Replacement cost (RC) earnings is a non GAAP measure used by the downstream fuel industry to measure and report earnings on a replacement cost basis. RC earnings adjust purchases of crude oil and refined fuel as if the product sold in a month had been purchased in that month, rather than the Historical Cost (HC) approach which reflects the prices at the time of purchase.

RC earnings exclude the impact of changes in crude oil and refined product prices on the value of inventory held by ZEL, thus it is a better measure of underlying performance.

The difference between Historic Cost earnings and Replacement Cost earnings is the Cost of Sales Adjustment (COSA).

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