

Integrated Performance Evaluation and Strategic Implication Report on Z Energy Limited

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Abstract: *Z Energy Limited is a New Zealand-based fuel company, founded in 2010. In 2013, Z Energy became a listed company on the NZX, and also started to trade on the Australian Stock Exchange publicly. This report focuses on Z Energy's non-financial performances and how they affect company's value. Z Energy has been devoting itself to sustainable development while the actual performances were usually under the expectations. On the other hand, Z needs to deal with the challenges raised from electric energy. Even though Z has been trying to positively respond to the market variations and expecting a promising future, the outcomes are less likely to be optimistic. From the macroeconomic perspective, Z is significantly influenced by global crude oil prices and forex rates, it is sensitive to the changes in market conditions. Although New Zealand has a low-inflation economic environment, the impact of international economic conditions will override the influence from the domestic market. However, Z has also made some achievements in supplying biofuels and developed a long-term cooperation with Fonterra. In addition, Z Energy has applied numerous methods, such as HSSE strategy, to improve employee involvement and loyalty, and adopts "Strengthen the Core" strategy to expand businesses.*

Keywords: *non-financial performances, valuation on Z, strategic management*

1. Introduction

Z Energy runs 208 retail and wholesale service stations across New Zealand. Z puts a lot of efforts to improve the reputation and relationship with customers, repay the society, which can also make a difference to the company's profitability.

As a for-profit entity, Z Energy not only stresses the importance of profits but also emphasises corporate social responsibility. Therefore, Z puts a lot of efforts to improve the reputation and relationship with customers, repay the society, which can also make a difference to the company's profitability. This report focuses on Z Energy's non-financial performances and how they affect company's value.

2. Sustainability Analysis

2.1 Reduction of carbon emission

Z Energy plans to realise the target of the reduction of carbon emission in five aspects, which are head office, suppliers, service stations, delivery process, and customer consumption. From the perspective of head office, Z announced that it had achieved 11% reduction in carbon emission because it has been trying to persuade employees to take more public transports. However, Z also realised that the performance in 2018 was under expectation because the number of flights taken by staff increased significantly, which greatly released a large volume of carbon.

As for collaborating with suppliers, Z established Sustainability Code of Conduct to Z Suppliers to eliminate the expectations of suppliers about sustainability and improve the efficiency. Besides, installing LEDs in stores, decreasing bunker fuel oil temperatures, and simplifying the packaging that has been used with additive imports were applied to achieve the reduction. Z Energy's strong intention for sustainable operation led it to manage the electricity use and it has made 6% decline, which was below the target (10%). Z Energy contributed the reasons of unaccomplished targets to the extension of network and a wider range of food and drinks. As for the efforts Z made in the process of fuels delivery, the adoption of new Euro trucks and drop-in fuels significantly reduced the distance travelled by 7.5% and carbon emission by 7%, which are both much lower than targets.

2.2 Reduction of waste

Z Energy started the sustainability plan since 2011. Specifically speaking, Z has worked hard to decrease the electricity use at 213 service stations by installing LED lights. However, Z increased overall demand for electricity by adding more ovens and fridges to improve the quality of food and beverage provided at the service stations. As a result, the electricity usage in 2018 was 6% greater than that of 2012.

As for the landfill waste, Z planned to reduce waste to landfill by 70% in the retailing process while Z decreased 60% of waste. Moreover, according to the disclosure of Z, reducing waste water in retail by 50% was not accomplished either. Although Z insisted that it has performed well in reducing wastewater in car washes services, and it declared that the unachieved target itself was unrealistic and the failure of accomplishment also resulted from 90,000 cups of coffee being sold weekly in service stations, the unaccomplished goal could still lead to sagging morale. Z Energy claimed that it plans to create a zero waste head office in Wellington while the quality of accomplishment was still under the expectation. Z attributed the reason to the increasing number of staff and claimed that it had maintained the same level of waste per person as it did in 2012.

3. Trading Conditions

New Zealand has a stable economic environment with only 0.4% inflation rate in the year 2018. However, considering that fuels industry is mainly influenced by changes in foreign exchange rate and global crude oil prices, the benefit of stability in domestic economic conditions might be overridden. According to the analysis of volumes consumption, petrol volumes for the financial year 2018 increase by 2% PCP, the growth rate is much higher than previous periods because of sustained lower prices. The volumes of diesel keep flat on PCP, while compared to last year, the volume has a 3% increase. The change of diesel volumes demonstrates a decelerating economy.

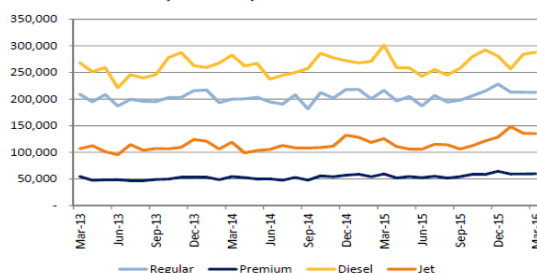


Figure. 1 Monthly industry volumes-kilo litres

In addition, market shares of diesel and petrol both indicate a declining trend, even though retail promotions have been adopted to fix the problem. It is noticeable that Z's ongoing portfolio management and the momentum are estimated to have sales growth in the financial year 2017.

4. Value Creation

4.1 Producing biofuels

Z Energy has put a lot of efforts in switching to biofuels, and gained supports from the market. Z Energy started to provide high-quality sustainable biodiesel from its 26 million NZD biodiesel facility in Auckland. The plant is fully staffed with professionals from a diverse range of processing industries. The plant can produce twenty million litres of biodiesel annually and the quality met the highest domestic and European fuel specifications. Feedback from vehicle drivers indicates that they are willing to use the new product. Not only motorists give positive responses to the sustainable fuel, but also large entities have expressed the interest in biodiesel. Specifically speaking, Fonterra became a foundation customer for Z Energy's biofuel since 2014. Fonterra has claimed trucks can use biodiesel wherever available around the country because of B5 is a drop-in fuel, the collaboration can be inferred as a long-term cooperation. The co-operative's 500 tankers of Fonterra cover more than 90 million kilometres of New Zealand road every year, which takes a lot of fuels. As a result, Z Energy's biodiesel can also be considered to be a profitable product.

4.2 Entering renewable energy market

Z Energy has a positive response to the competition and threat raised from new energy. Z installed six rapid chargers at Z sites in Auckland, Wellington and Christchurch. Furthermore, in January 2017, Z Energy announced that it will park two Audi A3 e-Tron electric vehicles at petrol stations in Wellington and offer a discounted rent price to customers. It is important to note that Z's positive response to electric energy would pose a threat to its traditional energy retailing business. According to the forecast of the acceptance of electric vehicles, 50% of imported cars would be electric by 2025, and by 2035, the number of second-hand petrol-powered cars will have greatly reduced to nearly zero. Z has obtained supports from the governing body, which provided \$40,700 to Z regarding the electric vehicle scheme.

4.3 Merge and acquisition transactions

Z Energy's inorganic growth contributes to the value increase for the company. Especially the investments in 15.4% share of Refinery NZ, which operates New Zealand's only oil refinery business and reduces Z, and 100% of Chevron's assets, which make Z become wholesale fuel supplier to Caltex-branded service stations' network. Apart from these two firms, Z purchased 20% shares in Loyalty NZ, which runs Fly Buys, 50% shares in NZ Oil Service Limited, 27.8% stakes in Wiri Oil Service Limited and wholly owns Harbour City Property Investment Limited.

5. Strategic implications

5.1 Positive impacts from Z Energy's business activities

Z Energy's non-financial performance helps the company win high reputation. From the positive aspects, Z's efforts made it be awarded to be one of New Zealand's best employers in 2015, which can improve the staff's involvement, which will lead to better operating performance regarding efficiency and profitability. On the other hand, Z's reaction to the changes in the market, such as electric energy and biofuels, and measures to sustainable development dramatically increase Z's reputation. According to the Colmar Brunton Corporate and Public Sector Reputation Indexes, Z was in the fourth place position among all New Zealand companies.

5.2 Uncertainties in the strategic measures

However, downsides also exist in Z Energy's behaviour. A large amount of spending on new energy would pose threats to Z's traditional energy business. During 2000 to 2007, Shell has worked hard in developing new energy area and it even collaborated with Siemens to found a solar energy company, which was estimated to be the fourth biggest solar energy firm in the world. Whereas, the limitations in technologies and other issues restricted the adoption of a business plan of Shell and Siemens. As a result, large losses forced Shell to stop the business and return to the traditional energy field.

6. Impact on Valuation

6.1 Non-fuel revenues adjustment

The acquisition of Chevron New Zealand in June 2016 was estimated to increase Z Energy's total revenues mainly because the transaction will add capacity for 146 service stations and market share of 49% of the entire New Zealand fuel retailing market. The previous forecast indicates that non-fuel revenue after Chevron acquisition keeps around 120 million NZD, which doubles the amount of the non-fuel revenues in 2016. Furthermore, revenues generated from fuels retailing activities are forecasted based on the assumption that market share of 49% can be maintained.

However, referring to the characteristics of fuel industry, the impact of the acquisition of Chevron New Zealand may not be as significant as it was assumed previously. Firstly, the structure of competition in the fuel market would not change dramatically. Even though the participants in the midstream reduced to three, which are Z, BP and Mobil, the market conditions are still unchanged. Allowing for that New Zealand fuel companies heavily rely on imported crude oil, and the products they offered have high similarity, no participant in the midstream owns the power to dominate the market. As a result, the forecasted revenues, especially non-fuel revenues may be somewhat overestimated. In addition, the

government has issued policies regarding anti-competitive behaviours in fuel industry also restricts fuel companies' market power.

The performance of Z Energy's fuel retailing transactions with aviation and marine industries will stay the same. Auckland Airport is the only airport that Chevron and Z overlap in the supply of jet fuel, but customers with strong bargaining powers are served through infrastructure that is shared on equal terms by BP and Mobil. As for marine, considering that Chevron was not a member who competed in the supply of marine fuel oils, the acquisition would not bring more revenues from marine industry to Z Energy. As a result, the previously forecasted non-fuel revenues should be adjusted to a more conservative estimate.

6.2 New energy retailing revenues adjustments

The habits of energy consumption in NZ indicate that electricity and oil usages constitute more than half of the total amount (69%). Thus, it is reasonable to infer that developing electric energy would bring in more extra revenues for Z Energy. However, the limitation exists in collecting relevant data of New Zealand companies. As a result, the assumption can only be made based on the ratio of Royal Dutch Shell's electric energy revenues to its total revenues, which is 4.5%. Subsequently, increasing both revenues and costs of goods sold by 4.5%, which would be the adjusted income and COGS.

7. Valuation

The adopted cost of equity number is based on the dividend growth model and the cost of debt is the current interest rate used for the forecast. Therefore, the applied WACC rate is 8.96%. In addition, taking account for the effects from new energy business and non-fuel business, the adjusted valuation for Z is \$3,485 million. Thus, the share price should be \$8.71 while the market price is \$7.20. Z Energy's share price is undervalued by 17.34%.

8. Conclusion

The result of valuation (\$8.71) is higher than the market price (\$7.20) as at 4th March 2018. When considering Z Energy's non-financial performances, the company's actual achievements were usually below its objectives. Z Energy tends to be optimistic about the financial performance in the future, which can be reflected in its attitude to the impact of the acquisition of Chevron and the threats from new energy, though the realistic situation inclines towards the conservative financial result.

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