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Ampol Limited

29 November 2021

Sector: Oil & gas
Sub-sector: Refining & Marketing
Country: Australia
Ownership: Public

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Issuer Outline

Ampol Limited (Ampol, Company) is the largest transport fuels company listed on the Australian Securities Exchange (ASX). Ampol (formerly known as Caltex Australia) has a history dating back 120 years and is Australia's largest branded petrol and convenience network operating over 1900 fuel and retail sites predominantly located in Australia (Ampol), New Zealand (Gull) and the Philippines (SeaOil).

It's an ASX-50 company, as at 25 November 2021 had a market cap of AUD7.3bn.

Ampol generates over AUD17.0bn in revenue through its two key operating segments:

- Fuels and Infrastructure – sourcing, importing, refining and distribution of fuels and lubricants to Ampol's predominantly commercial customers. Annually, Fuels and Infrastructure contributes approximately 80.0% of Ampol's core operating revenue; and
- Convenience Retail – sale of retail fuels and convenience products. Sites are operated through a combination of franchisees, strategic partnerships (such as Woolworths) and through Ampol itself. Its Convenience Retail segment accounts for the majority of remaining core operating revenue (AUD4.0bn).

Key Financials (AUDm)

LTM (30 Jun)	2021
Revenue	17,170
EBITDA	1,142
Net Interest Expense	(104)
Total Assets	7,964
Cash	64
Net Debt / EBITDA	1.6x
EBITDA/Interest Expense	12.4x

Source: Company, S&P IQ Capital and FIIG estimates

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0057683	AUD 500m	Subordinated Unsecured Hybrid	BBSW + 3.60%	Quarterly	09 Mar 2026	09 Dec 2080
AU3FN0064739	AUD 500m	Subordinated Unsecured Hybrid	BBSW + 3.40%	Quarterly	19 Mar 2027	02 Dec 2081

[1]*Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call*

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Strengths

- Strong competitive position: Ampol maintains a strong competitive position in the Australian fuel retail and commercial business. As at November 2021, the Company had over 1,900 company-owned or affiliated sites servicing a range of industries. Ampol has an integrated structure, enabling the Company to source and distribute crude oil products to domestic and international customers. Ampol's Lytton refinery (near Brisbane) is one of only two refineries in Australia, supported by a financial package through the federal government. Additionally, the Company operates Australia's largest import terminal, Kurnell, located in NSW.
- Government support of Lytton Refinery: In May 2021 Ampol announced its intention to continue refining operation at Lytton, with the support of the government's Fuel Security package. The package improves the quality of Ampol's earnings, as it significantly reduces the volatility risks associated with refining margins by providing a variable support payment (when margins drop below AUD6.4cpl) of up to AUD108 million per annum (until 2027 with an option to extend to 2030) which protects refinery earnings during periods of low margins, this virtually eliminates the downside risk. Further support has been provided to fund infrastructure upgrades (~AUD125m) to produce ultra-low sulfur petrol. Given the low refinery margins in 1H21, the Federal Government also provided a one-off grant of AUD40m to Ampol.
- Geographically diversified revenue and operations: Ampol has expanded its operation domestically and internationally over the past few years, with operations in the U.S. (Houston), Singapore, Philippines and Australia. Geographically diverse operations have enabled the Company to increase effectiveness of sourcing fuel, allowing the Company to efficiently supply its Lytton refinery. Once refined, Ampol uses its strong infrastructure capabilities (over 300km of fuel pipelines and over 90 bulk fuel storage hubs) to distribute to its commercial and retail customers.

  In addition to operating an integrated model, the Company has diverse operations in Australia, New Zealand and Philippines. Domestically, Ampol operates over 1,900 sites located in all of Australia's states, weighted toward the east coast of Australia (~83.6% by service station network). Further, the Company has operations in New Zealand via Gull (98 retail sites) and Philippines (SeaOil) through its 20% equity stake. Revenue from Australian operations accounts for approximately 78% of total revenue (~AUD12.0bn); revenue from Singapore (from Ampol's trading & shipping business) contributes approximately 18% (~AUD2.7bn) and revenue from New Zealand contributes approximately 3.7% (~AUD0.6bn).

  We see the proposed acquisition of Z Energy by Ampol as increasing this geographical diversity. Z Energy is the market leader in New Zealand, selling about 40% of fuel volumes across its 481 sites (BP, the second largest operator in the country, has 277 sites) and sourcing fuel from 11 import terminals across the country. As part of this transaction, Z Energy has agreed that it will divest its existing Gull operations to address potential competition concerns.
- Stable earnings with sound cash flow generation: The Company's integrated model and strong infrastructure base has allowed it to generate strong revenues, attracting strategic partnerships and a strong customer base. Ampol's partnerships with companies such as Woolworths (the Foodery), Uber (through UberEats), Toyota and NRMA in conjunction with over 80,000 business customers and over three million customers retail customers each week have provided a solid revenue base, noting that earnings were impacted by COVID-19 in FY20 given its exposure to the aviation industry and transport fuels. We expect Ampol's earning will return to pre-pandemic levels as economic conditions continue to improve.
- Conservative approach to capital management: Under the Company's capital management framework, Ampol's corporate financial strategy focuses on maintaining its investment grade credit rating. Specifically, under its capital management framework, the Company is targeting to maintain its leverage (net debt/EBITDA) between 2.0x and 2.5x, whilst maintaining a sustainable dividend payout ratio (between 50% - 75% of NPAT). If leverage rises above 2.5x, the Company has indicated it would focus its capital management initiatives primarily on debt reduction.

  Excluding low probability, high impact events (such as COVID-19), Ampol has continued to operate within its stipulated capital management framework. For example, from FY16 to FY20, the Company maintained leverage in a range of 1.3x to 2.0x, with its dividend payout ratio not exceeding 65%. Further, accounting for lease obligations at FY20, its leverage ratio (accounting for leases) was 1.6x.
- Sound balance sheet and strong liquidity: Ampol continues to maintain a sound balance sheet with ample liquidity. As at 30 June 2021, the Company had AUD2.0bn of available liquidity (mainly undrawn bank facilities).

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Strengths relevant to Subordinated Unsecured Hybrid Notes

- Optional Conversion to Ordinary Shares: If Ampol do not redeem notes at the First Optional Redemption Date, noteholders can request that all (but not some) of the notes be converted into shares at a redemption price 1% below the volume weighted average price (VWAP) over the reference period. This provides noteholders an exit strategy well ahead of the maturity of the notes. We note there is no certainty that the subsequent liquidation of the shares that would be received upon conversion will generate proceeds at least equal to the face value of the notes given potential fluctuations in the share price.

Risks

- Disruption from COVID-19 pandemic: Demand for hydrocarbons has reduced following measures implemented by domestic (Australian) and international governments to contain the spread of COVID-19. Most notably, the Company's Australian operations has faced declines in demand for jet fuel, diesel and softness in its Convenience Retail section.

  However we expect volumes to begin to recover as COVID-19 restrictions are progressively eased and consumer mobility increases, furthermore crude and refined product prices have continued to trend higher recently. For the six month period ended 30 June 2021, revenue improved to AUD9.8bn (from AUD8bn in 1H20), EBITDA improved to AUD237m (1H20 AUD226m) and the Company reported a NPAT of AUD326m, after reporting Net loss of AUD626m during 1H20 (which was largely driven by an impairment of non-current assets of AUD355m).

- Brand integration and rebranding from Caltex Australia and increased competition: Ampol operates in a highly competitive market with established players such as BP, United, 7-Eleven and now, Caltex. In relation to the latter, the Company received a termination notice from Chevron in 2019 for the use of the Caltex brand name in Australia, with Chevron electing to re-enter the Australian market through its Caltex brand.

  While it is expected that Ampol could save between AUD18.0m to AUD20.0m per annum in licensing fees, it is forecasted the Company will have to outlay in excess of AUD150.0m in capital expenditure over a two-year transition period (CY2020 to CY2022) to rebrand from Caltex Australia. The entrance of Chevron into the Australian market (via its acquisition of Puma and subsequent rebranding to Caltex) will further intensify competition. Further, the rebranding could cause confusion among Ampol's current customer base, adversely impacting Ampol with retail customers electing to purchase fuel from Caltex as opposed to Ampol

- Z Energy Integration: Although the Z Energy acquisition remains subject to a certain number of approvals, we believe Ampol will remain subject to integration risk if the transaction proceeds. While Ampol has been operating in New Zealand for a number of years, the size and scale of the proposed acquisition outside its home market will present challenges for Ampol, as would be the case in similar transactions. We also note that Ampol has agreed to divest its Gull operations in New Zealand (to address potential competition issues) and the overall economics of the Z Energy acquisition is in part tied to the value Ampol assumes it will be able to extract from the Gull divestment, which could fall short of expectations.

Risks relevant to Subordinated Unsecured Hybrid Notes

- Subordinated position of the notes: The notes are subordinated in all respects to Ampol's senior debt. There is no restriction on the amount of securities, guarantees or other liabilities which the Company may issue or incur and which rank senior to or equally with the notes. This means that, in the unlikely event that Ampol were to default, the recovery on the notes would likely be minimal.
- Interest can be deferred at Ampol's option: The terms and conditions of the notes allow Ampol, in its absolute discretion, to defer any interest payment and exercising this option will not constitute an event of default. We note that deferred interest would be cumulative and compounding, i.e. noteholders' right to receive any deferred amount would continue unchanged and noteholders would earn interest on such deferred payment. We note that, while any deferred interest remains unpaid, Ampol will be unable to declare a dividend (or undertake a share buyback) in relation to its ordinary shares.

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- Long-dated security: The notes have a 60-year term and there is no certainty that Ampol will seek to optionally redeem the notes at any time prior, even though the notes are callable from March 2026. As a consequence, holders wishing to recover their capital would need to sell their notes on market, at a price which may be lower than the face value of the notes.
- Equity conversion risk: Unlike many other similar corporate subordinated instruments, the Ampol notes do not benefit from the underlying call incentive as a reason for the loss of equity treatment benefit afforded by S&P Global Ratings (since Ampol is only rated by Moody's). In order to provide a similar call signal to the market while still complying with Moody's rating methodology, Ampol has granted noteholders a right to convert their notes to equity in the event the Company elects not to redeem the Notes on the Optional Redemption Date. It should be noted that this holder conversion right is a one-off only in relation to the first call date. If the Company does not elect to redeem the Notes and holders do not elect to convert, there would be no further incentive to call. Further, while the conversion price is set at 99% of the reference share price, this reference price is based on the volume weighted average share price over the preceding 20 trading days but there is no guarantee that holders electing to convert their notes will be able to sell their corresponding shares at a price sufficient to recover the full face value of their original investment in the Notes. We also note that, while the Company has indicated it will seek to ensure the shares issued as a result of a conversion would be listed on the ASX, there is no guarantee it would be the case, especially if Ampol was to be delisted from the ASX in the interim (which could occur upon Ampol being acquired).

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