Mid Cap

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Viva Energy: One energy company to consider

Reading Time: 5 Mins – By Team Ace Investors

Company Summary

Viva Energy Group Ltd (ASX: VEA) is an Australia-based integrated downstream energy company which supplies a quarter of the country's liquid fuel requirement. VEA is mainly engaged in making, importing, refining and delivering of fuels, lubricants, greases, chemicals, and bitumen. VEA has a diverse client base from various sectors and industries including, but not limited to, aviation, defense, marine, mining, transport, and other commercial fleets.

Moreover the Viva also has a retail fuel, lubricants and service distribution network, in partnership with Shell and Coles, at over 1260 locations and which continues to grow. The retail outlets are a combination of owned and self-operated, Shell Coles Express service stations and other outlets in partnerships with retail businesses such as Liberty and Westside.

The company operates across three different business segments, namely, Retail, Fuels and Marketing; Refining and Supply, & Corporates and overhead.

- **Retail, Fuels and Marketing**: This segment can be broadly segregated into two sub-parts, namely, Retail and Commercial. Viva Energy supplies and markets quality fuel products through a national network of retail sites, the majority of these sites are Shell branded. In the commercial segment, the company supplies fuels, lubricants and other specialty products to commercial customer and sectors.

- **Refining**: Viva Energy owns and operates one of the four refineries in Australia, the Geelong refinery, Victoria, which converts imported and locally sourced crude oil into petroleum products including gasoline, diesel, jet fuel, aviation gasoline, gas, solvents, bitumen and other specialty products.

- **Supply, Corporates and Overheads**: VEA also owns and has contracted access to a national infrastructure network comprising of import terminals, storage tanks, depots and pipelines positioned across metropolitan and regional Australia. Some of the import terminals and storage facilities include Clyde & Parramatta, Gore Bay Terminal, Newport Terminal, Pinkenba Terminal and related pipelines.

It has a market-leading position in Victoria and near-market-leading positions in most of other Australian states. It is the second-largest refined fuel supplier in Australia at 14.5 billion liters or 24% share of the 60-billion-liter market overall, second only to largest player Caltex Australia Limited with approximately 27% share.

Stock Summary

Stock Summary	VEA.AX
Price	$1.695 AUD
Share O/S	1.94bn
Market Cap.	$3.34bn AUD
Average Volume	3.424m
Free Float	1.06bn
EPS (TTM)	$0.036 AUD
P/E	47.22
DPS (AUD)	-
Annual Dividend yield (ADY)	-
Franking	-
Last Dividend Ex date	26-09-2019
Last Dividend Pay date	14-10-2019
ROE (%)	2.5%

VEA Details

Key updates, opportunities and threats

On 20th December 2019, Viva Energy announced that it has agreed with Shell Brands International AG (Shell) to extend its license of the Shell brand on retail automotive fuels in Australia, until the fiscal year ending December 2029 (Shell Brand License), with no major changes to the commercial terms and conditions. We believe that this will continue to benefit VEA in terms of high brand awareness and recall, the “Shell” brand has and will continue to support and grow retail automotive fuels business in Australia.

Viva Energy on 20th November 2019 announced that it has received final regulatory approval to acquire the remaining 50% interest in Liberty Oil’s wholesale business (Liberty Oil Holdings).

For the financial year ended 31st December 2019, we believe that the strong top-line sales growth, with sales volumes for FY2019 expected to be 14,600 to 14,700 million liters, approximately 4.3% up against the prior corresponding period. Weekly sales in the retail alliance channel are expected to approximately 65 million liters per week in the six months ending 31 December 2019 (2H2019), up 9.2% on the half-year ended 30 June 2019 (1H2019). Retail fuel margins are expected to contract as a consequence of oil price volatility and increased competition in the market. We believe margins for retail, fuels and marketing fell to around AUD 4.3 cents per liter in the second half of 2019, down from the first half's AUD 4.8 cents and AUD 5.2 cents for FY2018.

For the refining business, operational performance at Geelong Refinery to remain robust for FY2019 backed by optimized crude selection and the production slate. Following a sustained period of low refining margins in 1H2019, Geelong Refining Margin is expected to improve significantly in 2H2019.

As per the latest Guidance update for FY2019, the management expects FY2019 Group Underlying EBITDA to be approximately $625 - $655 million and underlying NPAT to be approximately $135 - $165 million. For Retail segment, the underlying EBITDA for FY2019 for the Retail business is expected to be approximately $548 – $558 million and the commercial segment’s EBITDA to be around $292 – $297 million.

We believe that the retail, fuels and marketing margins to improve considerably from current levels as Viva’s alliance and continued focus on cost improvement will start bearing fruit in the coming years. Costs of crude oil, other feedstocks and refined products account for a large part of VEA’s overall cost of sales and any volatility will have an impact on the bottom-line. Another risk is the demand for fuel products could decline if there is a significant displacement of petrol and diesel combustion engines in favor of alternative fuel vehicles, such as electricity, hybrids or gas-powered vehicles. The adoption of clean energy-based automobiles has been slow in Australia and any improvement in fuel efficiency could further prolong the transition.

Stock recommendation

Over the past few years, VEA has more than doubled its earnings, with its most recent figures exceeding its annual average over the past five years. VEA’s ability to maintain an adequate level of cash to meet upcoming liabilities is a good sign of its financial health. This suggests good control over cash and cost by management, which is a key determinant of the company’s health. Similarly, VEA has generated a good amount of cash from operations over the past few years. With net debt of just AUD 169 million at the end of June 2019, VEA is in solid financial health. Net debt to equity is negligible, supporting a healthy balance sheet.

Some of the strong points which makes us optimistic about VEA’s future outlook as there exists an infrastructure of storage terminals, pipelines and depots make for a considerable entry barrier for competitors and Viva boasts significant refined fuel distribution, supplying around 24% of Australia's national requirement; second only to Caltex Australia. Further, we believe the demand for refined petroleum products to grow in the next decade on the back of a growing population.

Based on the above given parameters, we believe that the current price points to be comfortable entry point. The group is about to release FY2019 results by end of this month. The stock is currently trading as $A1.695 down 1.453% on day-to-day basis. We would like to recommend **BUY** rating on the stock at current levels.