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Yovich & Co. Market Update

15th May 2022

As at 13th May	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11609.38	7467.59	3001.56	7387.94	32899.37	12144.66	0.9054	0.6409	1.50%
Week Close	11168.18	7307.68	3084.28	7418.15	32196.66	11805.00	0.9064	0.6257	1.50%
Change	-3.80%	-2.14%	2.76%	0.41%	-2.14%	-2.80%	0.11%	-2.38%	0.00%

In another rough week for equity markets globally, the NZ market fell heavily by 3.8%, following the US market which saw the Dow fall by 2.1% and the NASDAQ fall by 2.8%. The NASDAQ has now declined 26.5% since November. UK and European markets held up much better, ending in positive territory.

The US inflation rate eased slightly from 8.5% to 8.3% in the year to April, though still too high. The Federal Reserve is intent on getting on top of inflation, and markets are pricing in two more back-to-back 0.50% rate hikes at the next two meetings. Meanwhile, the RBNZ has their next monetary policy statement next week, and markets see a high chance of another large 0.50% increase in the OCR.

The April housing market report from REINZ shows sales volumes are down across the country by 31.7%, with a larger fall in volumes in Auckland, which tends to lead the rest of NZ. The house price index for Auckland has fallen 10.2%, while across the rest of the country it has fallen 3.4%.

US interest rates fell, with the US 2-year Treasury yield down 14bps to 2.59%, and the 5-year Treasury yield down 18bps to 2.86%. NZ interest rates also declined, with the 2-year swap rate down 35bps to 3.55% and the 5-year swap rate down 33bps to 3.74%. The NZD continued to fall against the USD, down 2.38% to 0.6257, while the USD continued to strengthen, with the DXY up to 104.55.

The biggest movers of the week ending 13th May 2022				
Up			**Down**	
Ryman Healthcare	6.46%		EROAD	-16.47%
NZX Limited	3.20%		Air New Zealand	-11.95%
Oceania Healthcare	2.06%		KMD Brands	-10.61%

Market Highlight – Closure of the Marsden Point Oil Refinery

Refining NZ was NZ's only oil refinery since it started operations in 1964. The site at Marsden Point was chosen because of its convenient deep water harbour, low earthquake risk, and the availability of flat land adjacent to the site. The refinery was expanded in the 1980's as part of Robert Muldoon's Think Big era, which included the 170km pipeline to South Auckland. While it was still in operation, it provided 70% of the country's fuel needs, with the remainder coming from imports.

The company's earnings were inherently volatile, being dependant on global refinery margins which move with the price of oil, and also on the USD exchange rate, which the refinery margins are set in. With more refineries being built in Asia that are much larger, have economies of scale to reduce costs, have cheaper labour costs, and have access to cheaper electricity than we do here in NZ, the refining margins have been squeezed to historical lows, notwithstanding recent oil price movements. Refining NZ see the long-term trend being lower refining margins, coupled with lower domestic fuel demand, expected to peak in 2027 as people move to the likes of electric cars.

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The decision was therefore made to restructure the company into an import-only terminal, with the company changing its name to Channel Infrastructure NZ (CHI). CHI will keep its storage tanks and the pipeline to Auckland, but is now in the process of decommissioning its refining assets. The result is a simplified company that has long-term contracts with BP, Mobil, and Z Energy to import, store, and distribute imported fuel, including all of the jet fuel to the Auckland International Airport. With fixed fee components, the earnings will be more steady, removing the exposure to refining margins and the USD exchange rate, and reducing electricity costs.

There has been some concern from protestors who argue that the government should step in and nationalise the refinery as a strategic asset, especially given recent geopolitical tensions in Europe that have sparked energy prices to rise. However, the crude oil has always been imported anyway, the difference now being that we no longer import crude oil, but 100% refined fuel. The refinery was never configured to refine oil produced in NZ.

This change will see CHI become an infrastructure investment, characterised by stable earnings and high cash flow generation, and low maintenance capital expenditure. Once the transition is finalised, the company plans to reinstate dividends within 1-2 years, with a proposed dividend policy of 60%-70% of normalised free cash flow, which supports deleveraging (reducing debt) to a target of 3x to 4x Net Debt to EBITDA, consistent with an investment grade rating.

With estimated tax losses of $350m-$400m following conversion, CHI will benefit significantly with no tax payable for years to come. Following a revaluation, the net assets of the company are equivalent to $1.33 per share, compared with the current share price of $1.07.

The conversion cost budget is $200m-$220m, and the transition is reportedly on track to remain within budget, which includes contingencies. CHI is issuing a new fixed rate 5.80% bond for a 5-year term to repay a portion of the company's more expensive existing bank debt. The bond is unrated, and provides investors with an opportunity to invest in a high yield bond before the company receives an investment grade rating.

Investment News

Oceania Healthcare (OCA.NZ) Announces Acquisition of Two Premium Villages

Oceania is acquiring Remuera Rise and Bream Bay Villages for $57m, and has an option to acquire 6.7ha of greenfield development land adjacent to Bream Bay Village. The acquisitions are funded by existing debt facilities.
Current Share Price: $0.99, **Consensus Target Price**: $1.57

Westpac (WBC.NZ) – First Half Profit Down 5%

Westpac has announced the first half year interim results, with net interest income down 0.7% compared to the previous corresponding period (pcp), and net profit down 5% on pcp. Driving net interest income down was a 15 basis point reduction in the net interest margin, due in part to lower spreads on mortgages a business lending. The interim dividend is $0.61 per share.
Current Share Price: $26.34, **Consensus Target Price**: $28.30

Pushpay Holdings (PPH.NZ) – Annual Net Profit Up 7%

Pushpay has announced their annual results, with net profit up US$2.2m to US$33.4m, up 7% year on year. Driving the increase was strong operating revenue, breaking through the US$200m milestone, up 13% on last year. Gross margin remained steady at 68%.
Current Share Price: $1.27, **Consensus Target Price**: $1.57