

The fuel retailer with 25% market share (ASX: CTX)

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- Caltex is a leading Australian fuel retailer with a 25% market share which operates in an industry with very high barriers to entry.
- It controls the full value chain of its product and logistics giving it a comparative advantage to its peers.
- Caltex's convenience strategy is market leading and done in conjunction with Woolworths, a major food retailer.
- The stock is attractively priced and has the optionality of a fully franked capital return.

Caltex is the largest Australian fuel retailer with a 25% market share. The industry is dominated by the Big 4 fuel retailers (in declining order of size): Caltex, BP, Shell (Viva Energy), Mobil and then independents including 7Eleven.

Australia imports 75% of its fuel requirement as final product (petrol, diesel and jet fuel) and refines the remaining 25% from imported crude oil. The industry is susceptible to the price of crude oil and currency fluctuations. Higher oil prices are usually negative for profitability – retailers sell less volume of fuel at lower margins.

Although the industry is highly competitive, being a large distributor provides scale benefits e.g. geographical spread of sites, beneficial cost of procurement and cheaper distribution per litre of fuel. The industry has very high barriers to entry for a scale player as it is virtually impossible to replicate not only the retail network but also the integrated logistical chain of storage depots and pipelines. Caltex earns about 80% of its profits from fuel retailing and convenience store income. The remainder is from its Lytton refinery in Brisbane.

Caltex has embarked on a strategy of expanding its convenience offering – this has been done via its Foodary offer which is usually in conjunction with a quick-service-restaurant like Guzman y Gomez or Boost Juice. The other leg of the strategy is a roll-out of 250 Woolworths branded Metro Stores over the next few years.

Caltex in our view is a high quality business and an attractive investment proposition for the following reasons:

1. **High quality operator** – Caltex has a top quality management team that has proven to be an efficient allocator of capital. Caltex also controls the value chain of its product, from sourcing, importation, refining to retailing thereby giving its operations flexibility

2. **High barriers to entry** – the industry has very high barriers to entry that make it virtually impossible for a new scale entrant. The financial metrics do not stack up – incumbents have the benefit of existing infrastructure that would cost multiple billions of dollars to replicate.
3. **Growth in convenience** – we view the growth in convenience, in particular Caltex’s relationship with Woolworths, as a positive factor. Woolworths is a highly experienced retailer that could add substantially to the relationship and de-risks the rollout of the 250 stores.
4. **Attractive valuation** - Caltex trades on an 11 times PE multiple – a very attractive valuation for a company of its scale, market positioning and asset backing. The stock has been sold down due to a high oil price and the negative impact on profits – but a lower subsequent oil price has reversed most of the negative impact which is not reflected in the share price to date. In addition there is the possibility of a capital return and a franking credit balance of close to \$800m.

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