Out of Scope

From: Andrew Hume
Sent: Friday, 1 May 2020 9:00 am
To: Gareth Wilson; Justine Cannon; Bertrand Ngai; Phillippa Fox
Subject: FW: Documents for today's meeting [UNCLASSIFIED]
Attachments: 30.04.20 RNZ Strategic Review Briefing Pack - MBIE.pdf; Refining NZ review overview.pdf

Andrew Hume
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From: Ellie Martel <Ellie.Martel@refiningnz.com>
Sent: Friday, 1 May 2020 8:42 AM
To: Andrew Hume <Andrew.Hume@mbie.govt.nz>
Subject: Documents for today's meeting

Hi Andrew,

As noted, please find attached the documents ahead of today's meeting with Refining NZ.

Nga mihi,

Ellie Martel
Government Relations Manager
Refining NZ

Mobile s 9(2)(a)
Web www.refiningnz.com

Strategic Review – Government Briefing Pack



Discussion Document – Working Draft

1 May 2020

Refining NZ will work collaboratively with government stakeholders throughout the Strategic Review process

Context

- Refining NZ is undertaking a Strategic Review to determine the optimal business model and capital structure for its assets that aims to maximise "through the cycle" returns to shareholders and deliver secure, competitive fuel supply for New Zealand
- All options are under consideration, including all options to make a significant improvement in the competitiveness of refining operations in New Zealand and the alternative of converting to an import terminal model. But there is no status quo option.
- Refining NZ has critical infrastructure in the New Zealand fuel supply chain today – and its assets, skills and capabilities have the potential to play a key role in the transition to a lower carbon economy

Process

- The Strategic Review has been planned in 3 phases. The current "Assess" Phase 1 is focused on identifying and assessing the available options. This phase is planned to run through to June 2020.
- As part of Phase 1, we are seeking input from a broad range of stakeholders, in particular customers and Government, to ensure our Board is able to consider the views and perspectives of all stakeholders as it makes the decision on which option(s) are preferred options to take forward.

Timeline 2020

March | April | May | June | July | August | September | October | November | December

Prepare

Phase 1
Assess the options

Phase 2
Build detailed plans for preferred option(s)

Phase 3
Implement

Timing TBD

Why is Refining NZ undertaking a Strategic Review?

The current processing agreements were entered into in 1995, however since this date there have been significant changes in the nature of the New Zealand fuel supply market

Refining NZ has invested to expand processing capacity and capability, reduce emissions and maintain facilities, but these investments have not delivered an acceptable return over the last 10 years

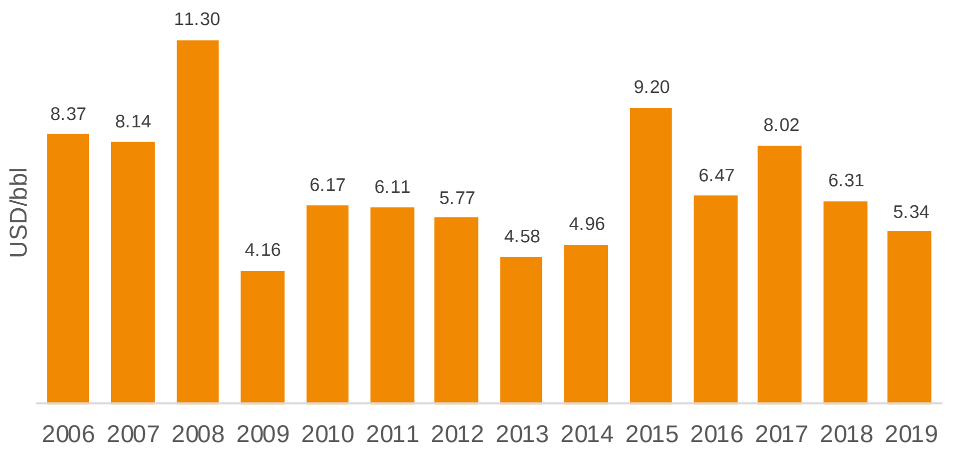
Significant new supply has come online in China, Korea, Singapore and India, and these larger integrated refining facilities in low cost economies are producing large volumes of low cost product putting significant downward pressure on regional margins

Low margins have been compounded by significant increases in the market price of electricity and gas in New Zealand, meaning that at the fee floor in the processing agreements Refining NZ does not cover its cash costs

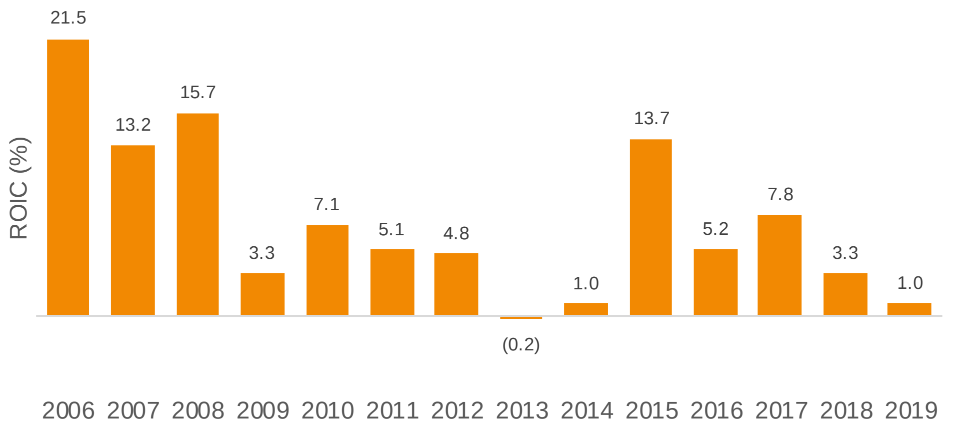
While COVID-19 is impacting operations in the short term, Refining NZ believes that the market conditions that have necessitated the review are structural

Refining NZ will work with its major customers and stakeholders to consider all options to provide a secure, competitive fuel supply to New Zealand now and into a lower carbon future

Refining NZ Gross Refining Margin, 2006-2019



Refining NZ Return on Invested Capital, 2006-2019[1]



1) 2006 was the first year for full adoption of NZ IFRS, comparing returns on capital in earlier years would be misleading

Refining NZ is evaluating all options, but there is no status quo options

As the independent operator of multi-user fuel infrastructure in New Zealand, we plan to consult broadly with stakeholders, including Government and customers, on the options under consideration

Strategic Review options

Continue current refinery model

- Improvements within the current refining operating model as a toll refinery (e.g. Right sizing production)

Alter refinery operating model

- Adjustments to the processing agreements, distribution arrangements (e.g. Merchant refinery)

Separate refining and infrastructure assets

- Changes to structure and funding profile e.g. entities with different risk profiles and returns

Convert to an import terminal

- Conversion from refining to terminal operations under new commercial arrangements
- Note – there may also be other options that emerge

Future Growth opportunities

- The Strategic review will evaluate growth potential under different operating models. This will include an evaluation of New Zealand's fuel distribution network
- Opportunities may exist for RNZ as the independent operator of shared infrastructure, to improve the resilience and performance of New Zealand's fuel supply chain
- Refining NZ also has options to progress its Maranga Ra solar farm project. RNZ is today the largest producer of hydrogen in New Zealand. Longer term, RNZ's facilities, skills and capabilities have potential to be used to produce green hydrogen.

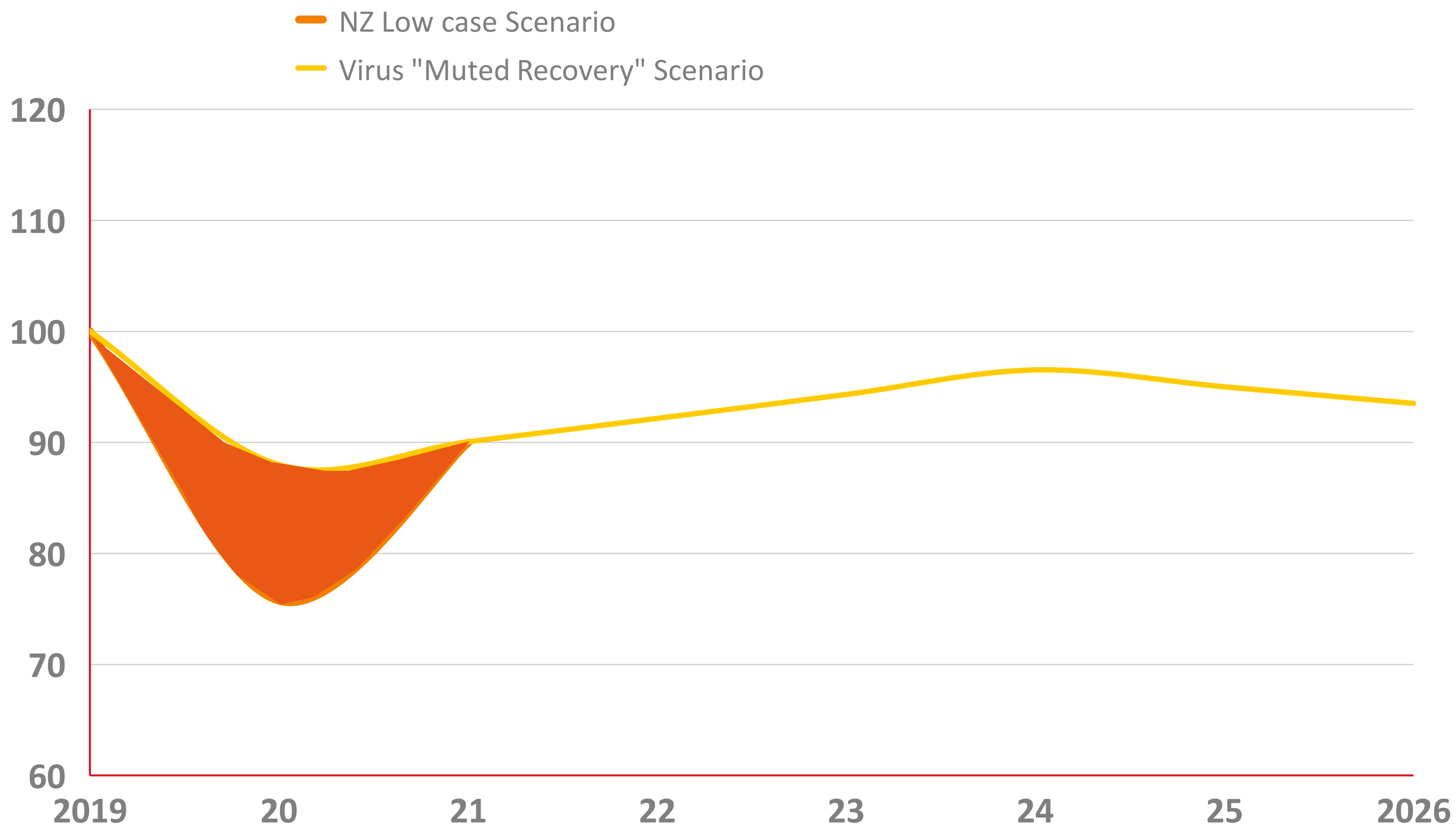
CONTEXT – WEAK DEMAND OUTLOOK

Transport fuel demand outlooks for 2020 and 2021 remain highly uncertain

REFINING NZ
Your Energy Hive
STRATEGIC REVIEW

Preliminary

NZ Demand Scenarios for transport fuel (Index, 2019 = 100)[1]



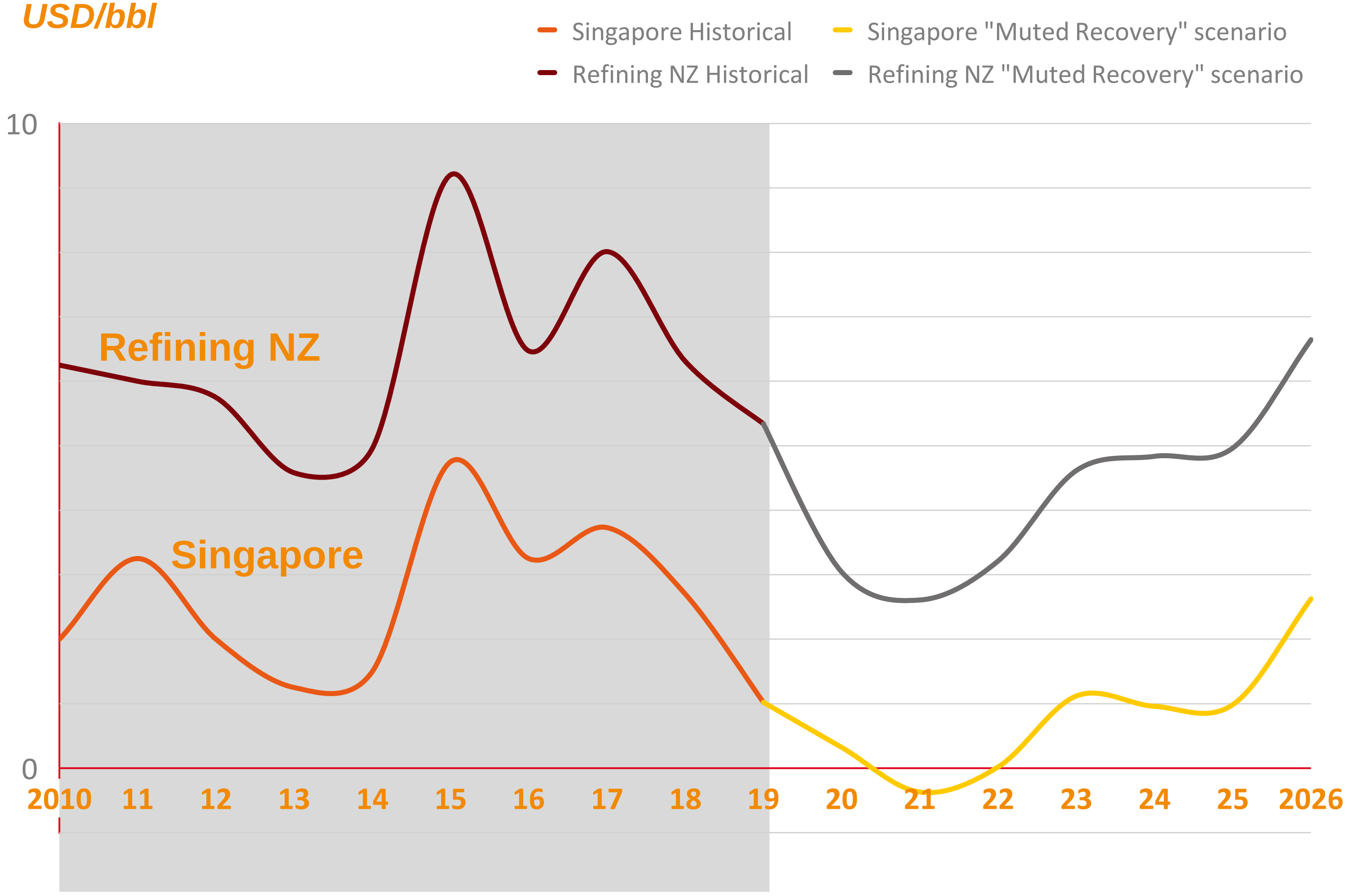
- Refining NZ is using a range of demand scenarios for 2020 – 2026
- These include the impacts of COVID-19 on short- and medium-term demand, ranging from a -12% to -25% 2020 impact (noting Q1 supply was largely pre-COVID impacts), but with the potential for lower downside scenarios as the broader economic impact of the COVID restrictions unfold
- As part of Phase 1, we are aligning demand forecasts for individual product types by different locations with customers
- RNZ is currently able to operate cash neutral at the fee floor in the processing agreements. However this is made possible by deferring all non-essential activity to 2021 and is not sustainable.
- As a high fixed cost facility, the refinery needs a high level of utilization to be viable.

1. Includes Petrol, Diesel and Jet fuel demand. Scenarios based on data available to 1st week of April 2020 – given COVID-19 uncertainty, assumptions subject to further change

Gross Refining Margins are expected to remain challenged through to 2026

Preliminary

Singapore Complex v RNZ Gross Refining Margin scenarios[1], *USD/bbl*



- Singapore complex margins have been on a declining trend since 2015, driven by emerging Chinese exports and new East Asian capacity additions outpacing lackluster demand growth
- Under the “muted virus recovery” scenario, margins may continue declining until 2021 as pent-up supply backlogs and slow demand growth offsets crude price increases
- s 9(2)(b)(ii) and s 9(2)(ba)(i) [redacted]
- Overall, RNZ margins are likely to remain under pressure over the outlook period, a result of greater than required regional refinery capacity amidst weak demand growth

1. Based on Publicly reported data, using FOB Singapore vs Dubai crude. Forecasts use RNZ’s view of the product yields, derived from IEA

CONTEXT – IMPROVEMENT OPPORTUNITIES

The Strategic Review will consider options to improve refinery financial performance and contribute to the NZ energy transition journey

Currently, our view is that the refinery is not able to earn its cost of capital through the cycle due to the changes in the underlying cost of operations and regional competitive conditions combined with the structure of the existing processing agreements

A fundamental change in the competitiveness of refining operations and the economics of Refining NZ's business model is required

Immediate opportunities

Crude slate and yield

Energy cost

Lower cash break-even

- Opportunities for improvement include
  - Optimisation of crude scheduling and diet
  - Sourcing lower cost energy
  - Advanced process controls to maximise higher value product yield and optimise energy consumption
  - Reduce maintenance costs through efficiencies and process alignment
  - Optimisation of turnaround cycles and duration
  - Adjusting total product volumes and mix
- This will be compared to alternative models e.g. an import terminal

Examples of opportunities to support New Zealand's transition to a lower carbon economy

Solar energy

- Progress Maranga Ra solar farm project

Hydrogen production

- New Zealand's largest producer of hydrogen – potential for green hydrogen
- Expectation is that hydrogen will be a key component of the future energy mix
- Provides unique capabilities for future transition to lower carbon fuels

Bio fuels

- Critical alternative for aviation and heavy trucking
- Access to land, water and renewable energy

MATTERS FOR GOVERNMENT INPUT

We are seeking the views of Government stakeholders on the following matters

The strategic importance to New Zealand of maintaining refining capacity in New Zealand

How the refinery today contributes to New Zealand's IEA obligation to hold oil stocks and what impact transition to an import model with product storage could have

Any potential changes in Government policy for fuel supply chain resilience requirements, as identified in the Pipeline Inquiry – or related to independent control of NZ's fuel infrastructure

Options for RNZ to access lower cost electricity and gas, including lower distribution charges

What should RNZ assume about longer term EITE allocations under the ETS

How RNZ's assets, skills and personnel capabilities may play a role in the New Zealand Government's planned transition to a lower carbon fuels future

Any other considerations the Government wishes to provide as input to the strategic review

We are seeking initial Government input on these matters by end of May so it can be considered prior to our planned NZX market update in June this year.
We are available to meet with MBIE and other Government officials as required.
Briefings will also be offered to relevant Ministers and MPs through the review.

Refining New Zealand briefing note:

April 30, 2020

PURPOSE

1. This briefing provides an update on the review underway to determine the optimal business model and capital structure for its assets that aims to maximise “through the cycle” returns to shareholders and deliver secure, competitive fuel supply for New Zealand

2. The first stage of the review is focused on identifying and assessing all options available to improve the financial performance of the refinery and realise the value of the company’s infrastructure. An update will be provided to the market in June on the preferred option(s) that the company intends to take forward.

3. Refining NZ seeks Government input into the review.

CONTEXT / BACKGROUND

4. The current processing agreements were entered into in 1995. Since this date, however, there have been significant changes in global and New Zealand fuel markets.
5. Refining NZ has invested to expand processing capacity and capability, reduce emissions and maintain facilities, but these investments have not delivered an acceptable return over the last 10 years.
6. Significant new supply has come online in China, Korea, Singapore and India, and these larger integrated refining facilities in low cost economies are producing large volumes of low-cost product putting significant downward pressure on regional margins.
7. Low margins have been compounded by significant increases in the market price of electricity and gas in New Zealand, meaning that at the fee floor in the processing agreements Refining NZ does not cover its cash costs.
8. While COVID-19 is impacting operations in the short term, Refining NZ believes that the market conditions that have necessitated the review are structural.
9. Refining NZ will work with its major customers and stakeholders to consider all options to provide a secure, competitive fuel supply to New Zealand now and into a lower carbon future. New Zealand imports all its crude oil for refining, mainly from the Middle East, Russia and Asia, and 70 per cent of the national demand for fuel is processed through Refining NZ facilities. The remaining fuel demand is imported after refining elsewhere.

OPPORTUNITIES

10. The review is considering the following four opportunities, bearing in mind that the status quo is not possible and that the preferred option may involve a combination of these:
    a. **Continue the refinery model** - Improvements within the current refining operating model as a toll refinery (e.g. Right sizing production)
    b. **Alter the refinery operating model** - Adjustments to the processing agreements, distribution arrangements (e.g. Merchant refinery)
    c. **Separate refining and infrastructure assets** - Changes to structure and funding profile e.g. entities with different risk profiles and returns
    d. **Convert to an import terminal** - Conversion from refining to terminal operations under new commercial arrangements

REVIEW UPDATE

11. The Project is being undertaken in three phases:
    a. **Phase 1**: Assess options (underway – to June 2020): Seek input from a broad range of stakeholders, in particular Government and customers, to ensure our Board is able to consider the views and perspectives of all stakeholders in its decision making.
    b. **Phase 2:** Build detailed plan for preferred option(s) (July on)
    c. **Phase 3:** Implementation (to be determined depending on preferred option)

NEXT STEPS

12. Refining NZ seeks Government consideration of/input into the four options.
13. In particular, Refining NZ seeks a response on:
    a. The strategic importance to NZ of maintaining refining capacity
    b. How the refinery today contributes to NZ's IEA obligation to hold oil and what impact transition to an import model would have
    c. Potential changes in Government policy for fuel supply chain resilience as identified in the Pipeline Inquiry – or related to independent control of NZ's fuel infrastructure
    d. Options for RNZ to access lower cost electricity and gas, including lower distribution charges
    e. What should RNZ assume about longer term EITE allocations under the ETS
    f. How RNZ's assets, skills and capabilities may play a role in the NZ planned transition to a lower carbon fuels future
    g. Any other matters on which the Government wishes to provide input to the strategy.

TIMING

14. Feedback is requested before Friday, May 29.