

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.