NZX Release

17 February 2021

Refining NZ reports 2020 full-year results

Summary

- An outstanding operational and financial response to one of the most challenging business environments in the Company's 60 years of operation.
- The Refining NZ team delivered the best personal and process safety performance on record with no recordable injuries or Tier 1 or 2 process safety events.
- Refinery and RAP throughputs were c.30% lower than 2019 due to the significant demand impact of COVID-19 travel restrictions.
- Singapore Complex Refining Margins were negative throughout most of 2020, reflecting structural overcapacity in the Asian refining sector exacerbated by the ongoing impacts of COVID-19.
- Gross Refining Margin of USD1.63 per barrel earned – the second lowest since the 1995 Processing Agreements came into effect – with c.$90 million of Fee Floor payments protecting the Company from the impacts of low margins and demand.
- Significant opex and capex reductions made (c.$80 million) to reset the 2020 cost base to cash break-even at the Fee Floor.
- Early action taken to strengthen the balance sheet by increasing and extending bank facilities, maintaining significant liquidity and covenant headroom and no material near-term maturities.
- Net debt down $10 million to $231 million, reflecting the financial discipline of cash neutral operations.
- A net loss after tax of $198.3 million, including the previously announced (after tax) non-cash impairment of the refining assets amounting to c.$158 million.
- Strategic Review undertaken and simplified refinery plans implemented to make the refinery robust to an extended period of low margins.
- Significant progress made assessing import terminal option, with potential to unlock latent value in our highly strategic infrastructure assets – in principle agreement reached with bp on key commercial terms (non-binding and subject to conditions).

Financial snapshot

Full year [1]		2020	2019	Change
Income	NZ$ m	**245.7**	348.4	(29.5%)
EBITDA[2]	NZ$ m	**50.4**	118.2	(57.4%)
Adjusted EBITDA[3]	NZ$ m	**58.7**	121.9	(51.8%)
Capex[4]	NZ$ m	**(33.9)**	(77.7)	(56.4%)
NPAT	NZ$ m	**(198.3)**	4.2	<nm>
Free cash flow[5]	NZ$ m	**11.0**	39.4	(72.1%)
Net debt	NZ$ m	**231.3**	241.4	(4.2%)

Commentary

Refining NZ today released its financial results, with Chief Executive Officer Naomi James reporting that the Company had safely navigated one of the most challenging business environments in its 60-year history while establishing a pathway to deliver shareholder value.

"The results reflect an outstanding effort by the Refining NZ team who responded quickly and decisively to COVID-19 - finding new ways of running the refinery, reducing the year-on-year cost base by c.$80 million, while delivering the Company's best safety performance on record. I am proud of what the team has delivered under such challenging business conditions," said Ms. James.

The weak refining margins prevailing at the start of the year, resulting from excess refining capacity in the Asia Pacific region, were exacerbated by the ongoing impact of COVID-19 across the 2020 year. "The global drop in demand triggered by COVID-19 and the expectation of a slow recovery in oil and refined product demand, particularly for jet fuel, weighed heavily on an already oversupplied market. Singapore Complex Margins were negative across most of the year and the Gross Refining Margin of USD1.63 per barrel earned was the second lowest in the 25-year history of the Company's Processing Agreements," said Ms. James.

The significant fuel demand reduction resulting from travel and transport restrictions, along with the reduction in revenue through weak global refining margins, required the Company to make significant operational changes – working in partnership with customers to reduce refinery production and non-essential activity on site. This included operating the refinery's processing facilities on a rotating basis to

[1] The financial statements have been prepared based on existing Group operations under the current Processing Agreements. The potential outcomes from the Strategic Review, which are not solely within the Company's control, may be substantially different from such existing operations and may therefore impact the financial performance and financial position of the Group in the future.

[2] EBITDA = Reported Earnings before depreciation, impairment, finance costs and income tax.

[3] Adjusted EBITDA = EBITDA adjusted for other non-cash expenses and used for bank covenant purposes.

[4] Capex = investing cashflow associated with property, plant and equipment (as presented in the consolidated statement of cash flows).

[5] Free cash flow – net cash flows from operating activities less net cash flows from investing activities.

enable the refinery to produce at substantially lower rates, as well as a full six-week shutdown of the plant in the middle of the year to help balance fuel supply across New Zealand.

"This mode of operating the refinery was unique, and to do so safely - with no process safety incidents or recordable cases - was an outstanding achievement. A significant number of our staff supported the business by taking leave during the six-week shutdown. This is a testament to the capability and commitment of our people. I would like to thank the entire team for their huge contribution and support as we navigated the challenges of COVID-19 and the turbulent market conditions," said Ms. James.

The safety of Refining NZ's workplace and the health and wellbeing of its people are core company values, at the heart of the on-site culture. The E Tu Tangata safety culture programme, an employee-led initiative, was a significant contributor to improved performance during the year and won the New Zealand Workplace Health and Safety Engagement Award in September 2020.

Refinery and pipeline throughputs for the year were c.30% lower than in the previous financial year. Throughput on the refinery was 29.9 million barrels (FY19: 42.7 million barrels) and the Refinery to Auckland Pipeline 14.7 million barrels (FY19: 20.8 million barrels). Land fuel volumes recovered to just above pre-COVID levels by the end of the year, while jet volumes remain weak at c.30-40% of pre-COVID volumes.

The Fee Floor provided protection against the impacts of both low margins and the reduced refinery throughputs.

Processing fee revenue prior to Fee Floor payments was c.$52 million (FY19: $242 million). In addition, Refining NZ customers were invoiced c.$90 million in Fee Floor payments, increasing the Gross Refining Margin from USD1.63 to USD4.40 per barrel.

The average Singapore Complex Margin (SCM) across the year was negative USD1.65 per barrel (FY19: +USD1.02 per barrel); the uplift earned by Refining NZ over the SCM was USD3.28 per barrel (FY19: USD4.32 per barrel). The reduced uplift reflects higher crude versus product freight costs and the impact of the COVID-19 induced rotating operations on refinery fuel and loss.

Refinery to Auckland Pipeline (RAP) revenue was down 20% due to lower volumes, partially offset by an increase in per barrel pipeline fees. Pipeline charges are expected to increase again in 2021, due to an increase in notional freight rates.

Total income for the year was $245.7 million, down $102.7 million (c.30%) on the previous financial year. The reported net loss after tax of $198.3 million includes the previously announced non-cash impairment of refining assets due to revised long-term margin assumptions.

Cost base reset to breakeven at the Fee Floor

The Company acted quickly to reset its cost base to operate within the Fee Floor, reducing year-on-year expenditure by c.$80 million[6] for the year.

[6] Excluding pass-through costs (natural gas, carbon credits and sulphur) and other one-off costs (including: restructuring, strategic review costs and an inventory write offs, totaling c.$11 million).

"This significant reduction in costs required a 'whole of business' response and strong financial discipline. This was achieved through a combination of both short-term measures – stopping and deferring all non-essential work and reducing variable costs due to the lower throughput – and through longer-term structural changes including a reset of our turnaround philosophy," said Ms. James.

Operating costs were down c.$35[5] million compared to 2019, with savings achieved in electricity and chemical costs due to cyclic mode of operation and hot stand-by contract renegotiations and stopping all non-essential activity on site. Capital expenditure was reduced by c.$44 million following changes to asset management strategies and the deferral of the platformer and crude distillation turnaround into 2021.

Significant liquidity and covenant headroom and no significant near-term maturities

The Company took early action to strengthen the balance sheet by increasing and extending bank lines, providing significant debt headroom and eliminating material near-term maturities.

Free cashflow was $11 million for the year (2019: $39 million) which allowed the Company to reduce net debt to $231 million as at 31 December 2020 (2019: $241 million). This reflected cash neutral operations and optimisation of the balance sheet through $13 million of asset sales, used partly to fund the restructuring that began in late 2020.

At year end, the Company had cash and facility headroom of c. $170 million. The Company remained in compliance with its debt covenants, with headroom on interest cover ratios expected to increase in 2021 due to the maturing of historical interest rate swaps in December 2020 and the benefit of lower floating rates.

Given the challenging low margin environment, Directors have resolved that it is prudent to not pay a dividend to shareholders in relation to the 2020 financial year.

Strategic Review undertaken, with plans well progressed to unlock shareholder value

Following the commencement of new CEO, Naomi James, the Company initiated a Strategic Review in April 2020 to determine the optimal business model and capital structure to maximise "through the cycle" returns to shareholders and deliver secure, competitive fuel supply to New Zealand.

A substantial increase in the supply of refined product from low-cost refineries, including integrated petrochemical producers, and lower than expected demand growth for transport fuels in the Asia Pacific region, resulted in a reduced outlook for refining margins. High energy, shipping and labour costs in New Zealand also affected the Marsden Point oil refinery's competitiveness. This reduced outlook for margins resulted in the Company recognizing an impairment of its refining assets amounting to c.$158 million after taxation in June 2020.

The first phase of the Strategic Review was focused on assessing all the options for the refinery and the alternative of conversion to an import terminal business model. Extensive stakeholder engagement was undertaken, including with customers and Government. This was completed in June, with the Company taking forward a near-term simplification of refinery operations to enable the Company to extend cash neutral operations in 2021 under a scenario where processing fee income is at the Fee Floor. In parallel, the Company commenced engagement with customers to evaluate a possible future staged transition to an import terminal.

Simplified refinery plans implemented, to make the business robust to an extended period of low margins

Plans to simplify refinery operations were finalised in October 2020 and implemented from January 2021, enabling Refining NZ to continue to operate the refinery safely in 2021 in a low margin environment and providing time to properly assess the import terminal option. Simplification included reducing total refined fuels production to levels similar to levels at the time of commencement of the Processing Agreement in 1995, and the cessation of bitumen production.

Naomi James said: "Simplification has involved change for everyone working at the Marsden Point site. We have had a strong focus through this time on operating the refinery safely and supporting our people who are affected by the changes we needed to make. We have worked closely with local, regional and national authorities and agencies to provide support to help our people transition, with the aim of having everyone impacted in new jobs or retraining within 6 months."

Significant progress made assessing the import terminal option, confirming potential to unlock latent value in our highly strategic infrastructure assets

Refining NZ is now well progressed in its assessment of the import terminal option, with an understanding of the costs and time involved in a conversion to an import terminal with Front End Engineering and Design (FEED) and detailed planning work now underway. The proposed import terminal system would have annual capacity of c.3 billion litres, supplying the Auckland and Northland markets which make up c.40% of the total New Zealand market.

Refining NZ has been negotiating with each of its customers, seeking to agree commercial terms which include a lengthy initial term (10+ years), a combination of fixed annual access fees and variable throughput fees linked to actual volumes – targeting total estimated fees (across all customers) of c.$100m p.a. during the initial term – and provision for third party access to unutilised RAP capacity.

Refining NZ announced today that Refining NZ and bp have reached in principle agreement on key commercial terms including price[7].

Refining NZ Chief Executive Naomi James said, "We have been working closely with all of our customers to negotiate terms on which we could recommend a transition to an import terminal business model to our shareholders.

"Reaching in-principle agreement on key terms with bp is a significant milestone which now allows us to progress preparations for the required approvals while continuing to negotiate to reach agreement with our other customers."

Negotiations with Z Energy and Mobil are ongoing, with Refining NZ focused on agreeing terms which are acceptable to customers and fair to non-customer shareholders.

[7] The in principle agreement is non-binding and subject to a number of conditions including Refining NZ reaching agreement with its other customers (Z Energy and Mobil), Refining NZ shareholder and lender approvals, completion of detailed planning and commercial due diligence, negotiation of a binding Terminal Services Agreement and final approval by the independent directors of Refining NZ and by bp.

Disputes in relation to the simplified refinery raised by customers are not currently being actively pursued while these negotiations continue. Some or all of the customers may decide to progress the disputes.

"There is a strong commitment from management and the Board to realise fair value for shareholders from the Company's strategic infrastructure assets while continuing to support secure, competitive fuel supply to New Zealand. Ultimately, any decision to proceed with a conversion to an import terminal will be a decision voted upon by the non-customer shareholders following an Independent Appraisal Report," said Naomi James.

Conversion to an import terminal would result in a 98 per cent reduction in carbon emissions for the site, making a significant contribution to New Zealand's emission reduction commitments, and would be the lowest emissions option for delivering fuel to the Auckland market.

Planning would also include looking at future opportunities to repurpose the Marsden Point site as a fuels and energy hub, with the potential to support future production, storage, handling, import and export of energy sources including biofuels, sustainable aviation fuel, hydrogen, LNG and electricity.

"An import terminal would require a much smaller footprint than our operations today and this could open up repurposing potential for the site given its strategic location next to a deep-water harbour and close to New Zealand's largest population base," said Naomi James.

Refining NZ continues to work closely with the local, regional and national authorities and agencies to ensure any future transition is smooth and the impact on its people and the region is minimized.

Refer to the investor presentation for further details regarding the potential import terminal conversion.

Outlook

The outlook for refining margins remains challenging in the near term, with COVID-19 travel restrictions likely to affect jet fuel demand through 2021, and significant refining capacity closures required to return refinery utilisation in the Asian region to more normal levels. Lower jet demand is expected to continue impacting RAP revenue, until New Zealand COVID-19 border restrictions are relaxed.

The Company's 2021 plan is focused on continuing to operate the refinery safely, completing the maintenance turnaround (deferred from 2020) and meeting commitments to customers under the Processing Agreements while operating within the Fee Floor.

The four-week turnaround, starting in late February 2021, includes the first statutory inspection for the CCR Platformer (Te Mahi Hou Project commissioned in 2015) and routine inspection and maintenance for the crude distillation unit and associated plant. During the turnaround, all other processing units not undergoing maintenance will be temporarily shut down, with customers importing refined products through this period. The estimated cost of the turnaround is c.$20 million, within a total capital budget of c.$50 million in 2021.

Refining NZ will host a results presentation call for investors and analysts at 11:00am, Wednesday 17 February 2021. Dial in instructions are available on the Company website at: www.refiningnz.com.

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