



The downstream fuels industry:

Strongly competitive or operating with uncertainty?

8 March 2012

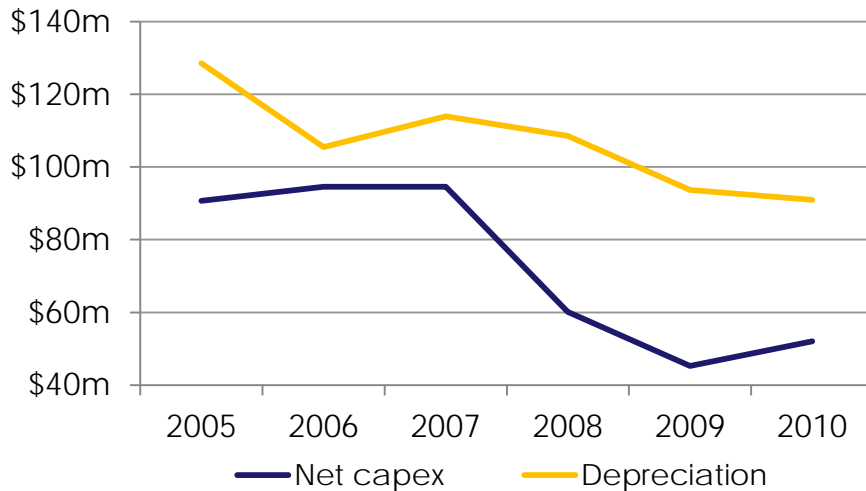


# A singular focus on efficiency



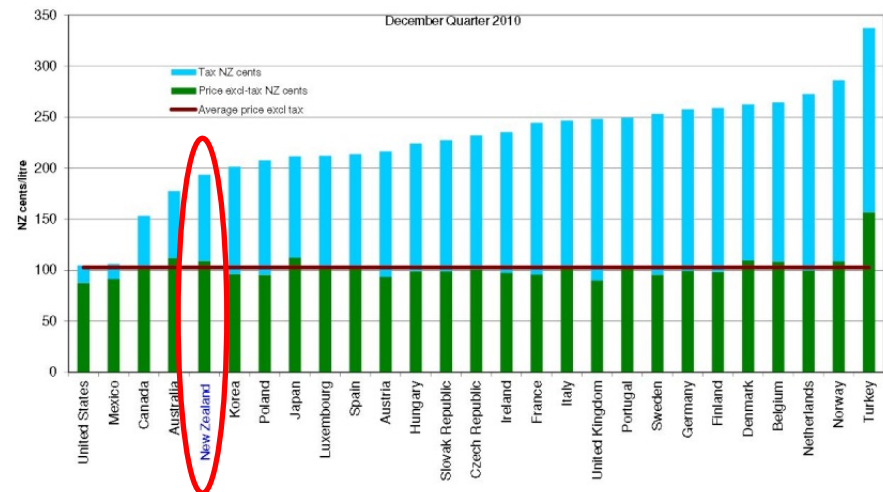
- Since deregulation in 1988, the downstream fuels industry has had a myopic focus on cutting costs and downsizing the capital base
- Consequences are accelerating – terminal and site closures, inconsistent offers
- Relentless drive for capital efficiency is reducing the industry's effectiveness
- The lowest possible price is great for the customer and the country... or is it?

### Capex is trending below depreciation



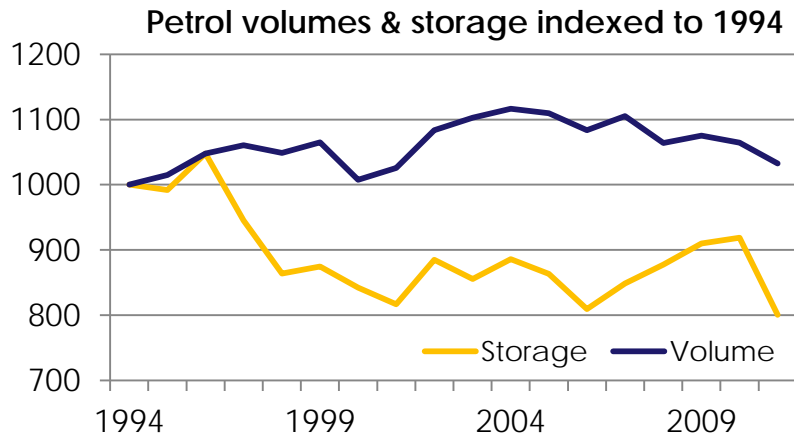
Source: BP, Mobil, Caltex & Z Statutory accounts

### Graph 8: Quarterly Comparison of Premium Unleaded Petrol Price and Taxes in OECD Countries

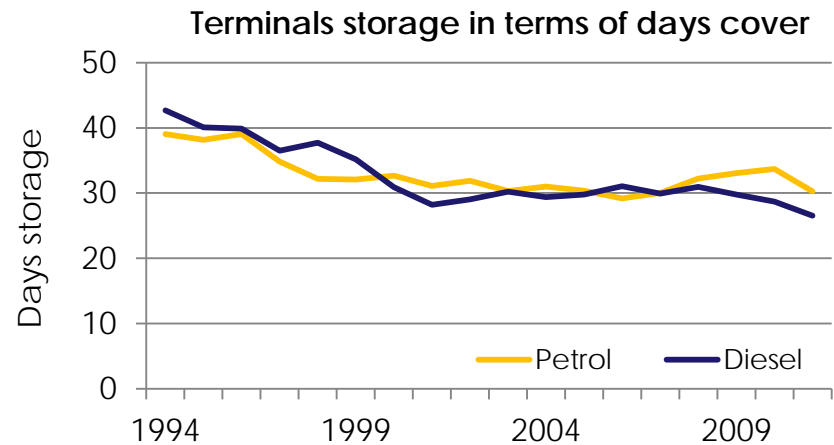
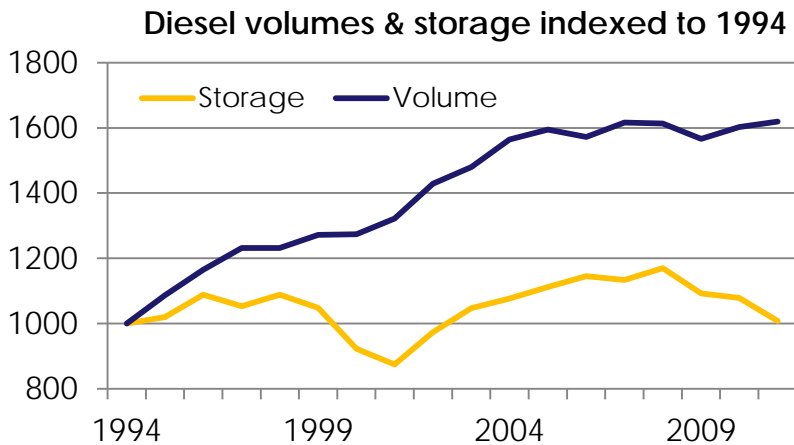


Source: MED

# Terminal infrastructure is under stress



- Petrol storage mothballed or switched to diesel as compliance costs are lower
- Example: storage at Port Timaru was halved last year
- Consequence: all petrol in Taranaki is trucked from Wellington or Mount Maunganui

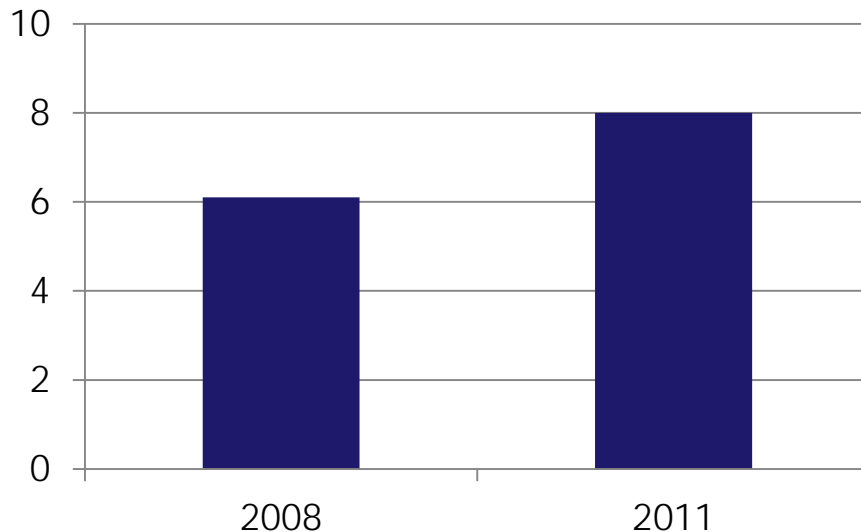


# Which is mostly opaque to the customer



- Refining NZ's reliability of >98% is top quartile but sometimes insufficient
- South Island ports are often "co-ordinated" as result of inadequate diesel supply:
  - In 2011: Timaru for 90% and Bluff for 54% of the time
- Fuel is regularly bridged into Canterbury from Bluff and Dunedin
- Consequence: more trucks on roads with impacts beyond our industry

Z Delivery Fleet: million kilometres per annum



Source: Z



# And there are other pressure points



- There were ~3,000 service stations in 1985 and only ~1,200 today
- It is a myth that all fuels are the same – Z research shows some contain no cleaning additive and some only sometimes
- While not compromising safety, there is relatively low contingency levels around key pieces of infrastructure
- Expect more majors to exit downstream in NZ in pursuit of higher returns



## Maui gas outage threatens North Island industry

11:36 AM Tuesday Oct 25, 2011

Tweet



Industrial gas users north of Taranaki are on short rations after the Maui gas pipeline was closed this morning to investigate reports of a leak in the critical supply line for natural gas to a range of industries, including electricity generators, dairy processors and food processors.



File photo



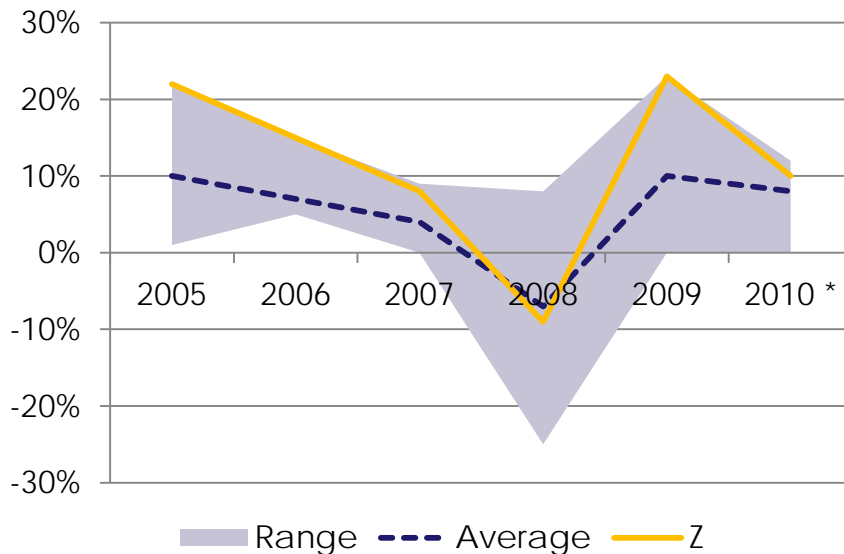
Under  
ready  
• Gas  
plan

# Why is this happening?



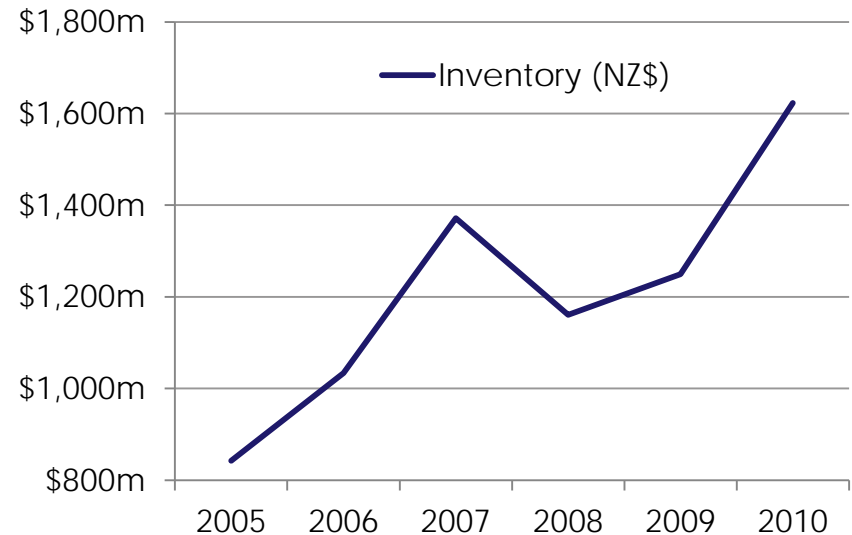
- The industry seems trapped in an economically unsustainable state
- Mid 1980s retail fuel margins were ~50cpl (real for Q1 2007 ex MED)
- Underlying commodity price has changed from long run average of US\$20/bbl to be consistently greater than US\$100/bbl since February 2011

Industry ROACE has averaged 5% for the past six years



\* Z's 2010 performance adjusted for one off revaluation

Inventory requirements have increased 88%



Source: BP, Mobil, Caltex & Z Statutory accounts

# So what is Z committed to?



- Contribute to an open debate around the sustainability of industry returns
- Engage stakeholders on what drives profitability and why that is so
- Renegotiate industry agreements to ensure:
  - Recharges are based on commercial terms and returns at WACC
  - Z's scale is adequately rewarded
  - Sufficient incentives to invest incremental capital
- Selectively invest if and when price signals are supportive
- Factor into price decision making all costs including the balance sheet
- Investigate opportunities for industry consolidation
- Focus business performance on capital and equity returns and not measures like market share

# We maintain a positive outlook



- Our acquisition price reflected these strategic challenges
- Addressing the issues grows earnings and free cash flows
- Further progress has already been made in FY12, e.g. margins, capital recovery charges, Lyttelton tanks, positive response to brand change and service offers
- Refining NZ growth project is an important signal

## Beyond the core possibilities

- Now have capacity and capability
- Biofuels options still in play
- Alliance with EROAD
- Strategy to Board in April

