REFINING NZ
Your Energy Hive

HY20 INTERIM RESULTS

Summary

- An outstanding safety and operational performance in 1H20 with no recordable injuries or Tier 1 or 2 process safety incidents including through COVID-19, when the refinery was operated on a rotating basis.
- Refinery and RAP throughputs were 27% lower than the prior corresponding period due to COVID-19 travel restrictions, with land fuel volumes recovering to near normal levels by period end, while jet remained weak.
- The Fee Floor protected the Company against low refining margins and COVID-19 impacts on throughput, with Processing Fee revenue of NZ$70 million, including Fee Floor payments of NZ$39 million.
- Significant (circa $70 million) reduction made in 2020 opex and capex plans, reducing the Company's 2020 cash break-even to Fee Floor levels from Q2.
- Income was down $52.5 million (30.6%) on prior corresponding period largely due to lower margins and throughput, while EBITDA was down $38.7 million (71.5%), with cost reductions partly offsetting the lower revenue.
- Net debt at 30 June was $250 million, reflecting cash neutral operations since April 2020.
- Early action to strengthen the balance sheet providing significant debt headroom and no material near-term maturities following extension and increase of bank lines.
- Strategic Review well progressed, with short- and longer-term options identified.

Commentary

Refining NZ has safely navigated the on-going impacts of COVID-19 and volatile refining markets, while resetting its 2020 cost base to operate cash neutral in the current low-margin environment.

Chief Executive Naomi James said: “It is a significant achievement to have safely navigated the impacts of COVID-19 and volatile refining markets, while resetting Refining NZ’s 2020 cost base to operate cash neutral in the current low-margin environment and taking early action to make the balance sheet robust to an extended period of low margins.

“This achievement was made possible by the wider team at Refining NZ who have impressed me with their ability to immediately respond to the scale of the challenge, while maintaining a relentless focus on the imperative of safe operations”.

Half year [1]		**2020**	2019	Change
Income	NZ$ m	**119.1**	171.6	(30.6%)
EBITDA[2]	NZ$ m	**15.4**	54.1	(71.5%)
Adjusted EBITDA[3]	NZ$ m	**20.5**	56.2	(63.5%)
Capex	NZ$ m	**(22.0)**	(29.8)	(26.2%)
NPAT	NZ$ m	**(186.3)**	(3.5)	<nm>
Free cash flow	NZ$ m	**(8.3)**	18.2	<nm>
Interim dividend	cps	0	2	<nm>

Income was down $52.5 million (30.6%) on the prior corresponding period due to lower margins and throughput, while Adjusted EBITDA was down $35.7 million (63.5%), with cost reductions partly offsetting the lower revenue. Free cash flow in the first six months was an outflow of $7.9 million, all within the first quarter, followed by cash neutral operations since April 2020. The Company reported a Net (Loss)/ Profit after Tax (NPAT) of ($186.3) million (1H19 NPAT: ($3.5) million) for the six months ended 30 June 2020, which included the previously announced non-cash impairment of its refining assets amounting to $158 million, after tax.

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 Company in the future.

[2] EBITDA = Reported Net Profit/(Loss) before depreciation, disposal costs, impairment, finance costs and taxation.

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

Strong safety and operational performance

The business achieved excellent process and personal safety performance with no Tier 1 or Tier 2 process safety events or recordable injuries. There has been no Tier 1 or Tier 2 events in the last 2 years.

The refinery continued to operate as an essential service throughout COVID-19 Alert Levels and Refining NZ established a Co-ordinated Incident Management System structure to implement business continuity plans during this time. Refining NZ successfully adapted work practices and behaviours during the COVID-19 lockdown, to ensure everyone on site continued to work safely and their health and wellbeing was protected.

Chief Executive Naomi James said: "We acted quickly and decisively in response to COVID-19 working in partnership with our customers to manage stocks and ensure reliable supply across the country by operating the plant in rotating mode to reduce refinery production, as well as reducing non-essential activity on-site."

"The Refining NZ team have had a relentless focus on safe operations through this period, reducing production to around 50% of normal levels as the COVID-19 travel restrictions impacted demand, enabling our customers to manage stock levels, while ensuring continuity of supply. This mode of operation was unprecedented for the refinery and our ability to operate safely in this changed mode reflects our highly capable workforce and strong operational discipline," said Naomi James.

Refinery and pipeline throughputs for the six months ended 30 June 2020 were 27% lower than the same period in 2019 and circa 40% lower from the time that the pandemic was declared. Throughput on the refinery was 15.4 million barrels (1H19: 21.2 million barrels) and pipeline 7.5 million barrels (1H19: 10.3 million barrels) in the six months ended 30 June 2020.

"Diesel and petrol demand had recovered to pre-COVID levels, prior to the latest lockdown measures announced by the New Zealand Government on 12 August, while jet demand remains weak at around 40%. This continues to impact on the way in which we operate the plant and our revenue, given the reduced supply of jet fuel into Auckland Airport," said Naomi James.

"We continue to work closely with our customers to help manage fuel supply in this uncertain market. After operating the processing units on a rotating basis for three months to reduce production, we are now restarting the refinery after a 6-week temporary shutdown, from early July, in order to balance fuel supply across the country."

Fee Floor protection from margin and demand downside

The Company operated at the Fee Floor in the first half of the year given the weak global refining margins and low refinery throughput, as a result of COVID-19.

"Global refining margins weakened towards the end of 2019 from the excess refining capacity, particularly in the Asia-Pacific region. This continued into the first quarter, before the impacts of COVID-19, which exacerbated the situation and further weakened refining margins. Because the Fee Floor

guarantees a minimum level of processing fee income each year, it provided a protection against the impacts from both low margins and the reduced refinery throughputs", said James.

Processing fee revenue earned in the first half, prior to Fee Floor payments, was $31 million (1H19: $117 million). In addition, Refining NZ's customers made Fee Floor payments totaling $39 million, increasing the Gross Refining Margin (GRM) from USD 1.81 per barrel to USD 4.10 per barrel.

The average Singapore Complex Margin (SCM) in the six months ended 30 June 2020 was a negative USD 1.60 per barrel (1H19: USD 0.21 per barrel); the uplift earned by Refining NZ over the SCM, was USD 3.42 per barrel (1H19: USD 5.10 per barrel). Uplift over the SCM was volatile in the half, impacted by higher crude freight rates and discounting of crude as the significant oversupply and build in crude oil inventories caused by COVID-19 led to the use of shipping as floating storage.

Reset 2020 cost base to reduce cash-breakeven to Fee Floor levels

COVID-19 had a significant impact on Refining NZ's revenue through the weak global refining margins and the lower refinery and pipeline throughputs.

"At the start of this year, our cash break-even level was significantly higher than the Fee Floor in our Processing Agreements. In response to the low margin environment and COVID-19 impacts on demand, we have reviewed all expenditure planned for 2020 and reduced it by around $70 million. This represents a circa 25% reduction in forecast opex and capex and has reset our 2020 cash-breakeven to Fee Floor levels. We achieved this reset through both short-term measures – stopping and deferring all non-essential work and reducing variable costs with lower throughput – as well as longer-term, structural changes which will reduce our cost base on an ongoing basis through, as an example, a reset of our turnaround philosophy and asset management strategies", said James.

Operating costs reported in the first half of the 2020 year were $8 million (7%) lower than the prior corresponding period in 2019 (excluding natural gas pass-through). Operating the plant in rotating mode, resulted in significantly lower variable costs, particularly electricity.

Capital invested in the 1H20 amounted to $22.0 million (1H19: $29.8 million), largely in relation to tank maintenance. Capex guidance for the year has been reduced a further $5 million for the year to $35 million, a 50% reduction in previous guidance of $70 million.

Strengthened balance sheet position with significant headroom and no near-term maturities

In the first half, Refining NZ extended and expanded its existing bank facilities, increasing the weighted average term of total debt to over five years and adding $50 million of additional capacity, which brought the total available debt funding facilities to $400 million (including the company's $75 million subordinated notes on issue).

Refining NZ continues to meet its gearing and interest cover covenants in the current low margin environment while operating at the Fee Floor.

Naomi James said "Refining NZ acted early as the COVID-19 situation was developing to strengthen its balance sheet, which now provides us with the runway for value creation through the Strategic Review.

"The Company has no significant maturities until 2023 and continues to meet covenants, as a result of the proactive steps taken by management and the Board to reset the cash-breakeven level of the business and operate within the Fee Floor in the current low margin environment.

"The ability to extend these facilities in the current business environment is a demonstration of the commitment and support of the company's banks," said James.

Given the challenging low margin and demand environment the Company is operating in, the Company's Directors have resolved that it is prudent to not pay an interim dividend to shareholders.

Strategic Review well-progressed

In April, Refining NZ commenced a Strategic Review to determine the optimal business model and capital structure for its assets to maximise "through the cycle" returns to shareholders, and deliver secure, competitive fuel supply to New Zealand.

The first phase of the Strategic Review was completed in line with planned timing and an update was provided to the market on June 25. The Company is now developing plans to simplify refinery operations and structurally reduce operating costs, making the business robust to an extended period of low-margins.

In parallel the Company is engaging with customers to evaluate a possible future staged transition to an import terminal.

Naomi James said, "Simplification of our refinery creates the time and optionality to continue refining operations in the near-term while we assess the potential option to transition to an import terminal in the future. We continue to work closely with our customers to assess the longer-term options and with Government and other stakeholders to ensure there is a planned and coordinated approach to future changes."

A further update on the Strategic Review process is expected to be made around the end of the third quarter.

Outlook

Refining NZ expects GRM to remain volatile in the near term. Singapore Complex Margins are expected to improve in the second half, but remain weak, compared with historic levels. Refining NZ's uplift is expected to continue to be volatile due to COVID-19 impacts to oil and refined product demand and current high levels of inventory globally, which are expected to take an extended period of time to unwind.

Following the temporary shutdown in July and August, the refinery will operate in a low production mode to meet improved fuel demand based on customer requirements. New Zealand demand for jet fuel is expected to remain impacted by COVID-19 through this year.

The Company has operated on a cash neutral basis since the COVID-19 lockdown and plans to extend this through the remainder of the year, when factoring in the Processing Fee Floor and reduced RAP income[4]. Higher variable costs when the refinery returns to low production mode will be offset by lower cash costs and terminal revenue during the temporary refinery shutdown in July and August.

"I acknowledge that shareholder returns on our capital base are unacceptable and must be addressed. In the current low margin and volatile environment, our focus is on keeping our cash break-even level at the Fee Floor, to ensure the Company can withstand an extended period of low margins. Action taken this year and planning underway to simplify and maintain this lower cash breakeven level into next year, ensures we have the runway to determine the right future path for the business, which enables a return to profitability and the payment of dividends for shareholders", said James.

Refining NZ will host a results presentation call for investors and analysts at 11:00am, Monday 17 August 2020. Please contact Lizzie Thompson at lizzie.thomson@refiningnz.com for dial in details.

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[4] Prior to any Strategic Review implementation costs.