APPENDIX B: ERNST & YOUNG DOWNSTREAM OIL INDUSTRY FINANCIAL SURVEY 1999

DOWNSTREAM OIL INDUSTRY

FINANCIAL SURVEY

JANUARY 1995 - DECEMBER 1999

SURVEY CONDUCTED BY

ERNST & YOUNG ON BEHALF OF

AUSTRALIAN INSTITUTE OF PETROLEUM LTD

SEPTEMBER 2000

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INTRODUCTION

This is the tenth publication in the series of the Downstream Oil Industry Financial Survey conducted annually by Ernst & Young on behalf of the Australian Institute of Petroleum Ltd (AIP) and covers the five calendar years 1995 to 1999.

Through an annual review of the financial position and activities of the industry's operations, the Survey provides aggregated data of the industry's significant role in the economy, enabling comparison with other sectors of the economy.

This Survey comprises the downstream activities of those companies involved in both petroleum refining and marketing (including associated merchandise trading) in Australia. This covers the majority of the Australian downstream oil industry, including all of the refining segment but not including the marketing activities of the independent retail sector. The exploration, production and non-oil activities of the refiner marketing companies in Australia are not included.

For the first time, this year's Survey reports the financial performance and position of the Refining and Marketing segments separately.

The tables in this Survey have been prepared by Ernst & Young, based on information supplied in confidence by the participating refiner marketing companies:

- BP Australia Limited
- Caltex Australia Ltd *
- Mobil Oil Australia Pty Ltd
- Shell Australia Limited

No individual company's response has been or will be made available to AIP or any other body. While Ernst & Young has reviewed the responses for consistency, the responses have not been audited and responsibility for the data rests with the companies supplying the data.

* Over the five year Survey period, data has been provided by the following entities:
1995 to 1997: Australian Petroleum Pty Ltd (trading as "Ampol")
1998 to 1999: Caltex Australia Ltd

SURVEY OVERVIEW

Profitability

- The downstream oil industry has experienced a fall in underlying profitability (i.e. profit after adjusting for stock gains due to crude oil price rises) in 1999. The Survey shows that underlying net profit after tax for the year was $221 million, a decrease of $263 million from the prior year.

- The industry continues to experience high levels of competition, with the combined effects of new entrants, the developing import sector accessing the over supply of petrol and diesel in the Asian region, and the very low international refining margins.

- Of the $221 million underlying net profit after tax, the Refining segment returned losses of $61 million. A positive result of $282 million was achieved in Marketing activities.

- Operating, marketing and production expenses have been reduced by $37 million or 1.5% from the prior year, compared with the increase in sales volumes of 1.2%. Including depreciation, on a per unit basis, these costs have been reduced from 6.4 cents per litre in 1995 to 6.0 cents per litre in 1999, a decrease of 6.3%.

- Despite these improvements in efficiency, the industry again failed to generate earnings commensurate with the size of its operations and the significant investment involved. Underlying net profit after tax was less than 0.5 cents per litre in 1999.

- International price comparisons show the Australian industry to be highly competitive, with Australian retail petrol prices (excluding tax) continuing to be the lowest in the developed world.

- Aggregate sales volumes increased by 584 megalitres in 1999. However, this was supported by an increase of 738 megalitres in the volume of refined product imported from overseas, reflecting the impact of the local industry's competition with low cost imports.

- Statutory accounting profits include stock gains and losses arising from fluctuations in the price of crude oil over a year. Over the course of 1999, the crude oil price increased from US$12/barrel to US$25/barrel, as illustrated in Appendix 1. In 1999 these fluctuations are estimated to have increased accounting profit after tax by $450 million.

- Accounting profit has also been increased by the forthcoming reduction in income tax rates, which in the current year has required the recalculation of deferred tax balances. This change in tax rate has given rise to an accounting benefit of $86 million.

- Over the five years of the Survey period, the industry has reported increased sales volumes while at the same time reducing fixed assets, operating expenses (in real terms) and the number of employees. In this same period, profits and unit margins have remained relatively static, as the benefits derived from increased capital and operating efficiency have been passed on to the consumer.

Capital Investment

- In 1999, property, plant and equipment employed in the industry continued to decrease. These assets totalled $5.8 billion at the end of 1999, compared with $6.3 billion in 1995. Depreciation and asset rationalisation have exceeded the rate of new investment in the industry during this period of low profitability.

- Over the five year period of the Survey, new investment has totalled $2.5 billion, contrasting with aggregate underlying profit after tax of $1.7 billion.

Environment

- Total readily identifiable environmental expenditure amounted to $139 million in 1999. This expenditure represents 34% of the current year's underlying profit after tax.

Cash Flow

- Cash from operating activities in 1999 was $220 million, the lowest of the Survey period, reflecting the high costs of inventory and low returns to the businesses. At the same time, borrowings were increased by $138 million.

Payments to Governments

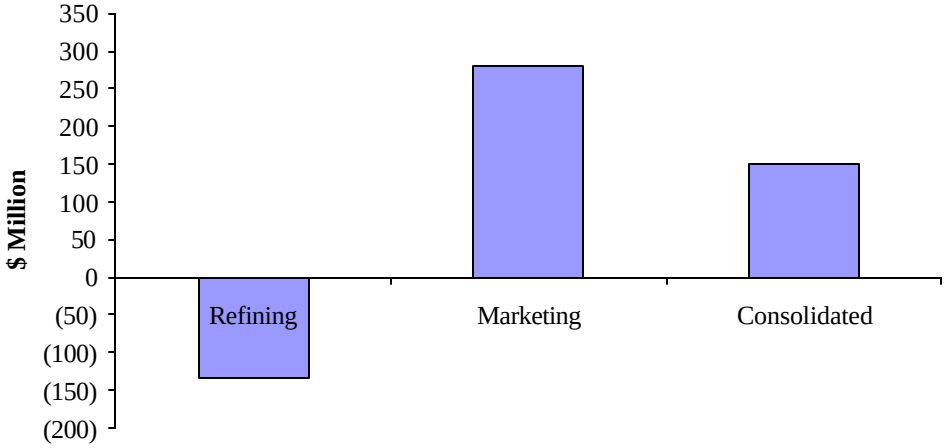
- Gross payments to governments amounted to $12.9 billion in 1999. The bulk of these payments were Federal excise duties, totalling $12 billion in 1999 (after state government rebates).

Employees

- The downstream oil industry continues to be a major employer. The refiner marketing companies directly employed 6,557 people at 31 December 1999, and indirectly employ substantially greater

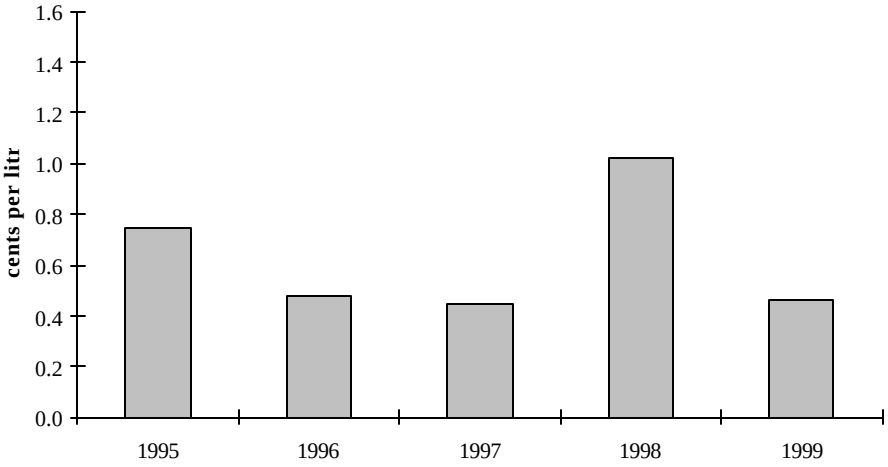
numbers in retail and other wholesale sectors of the industry.

1999 Profit/(Loss) After Income Tax (Before Extraordinary Items)



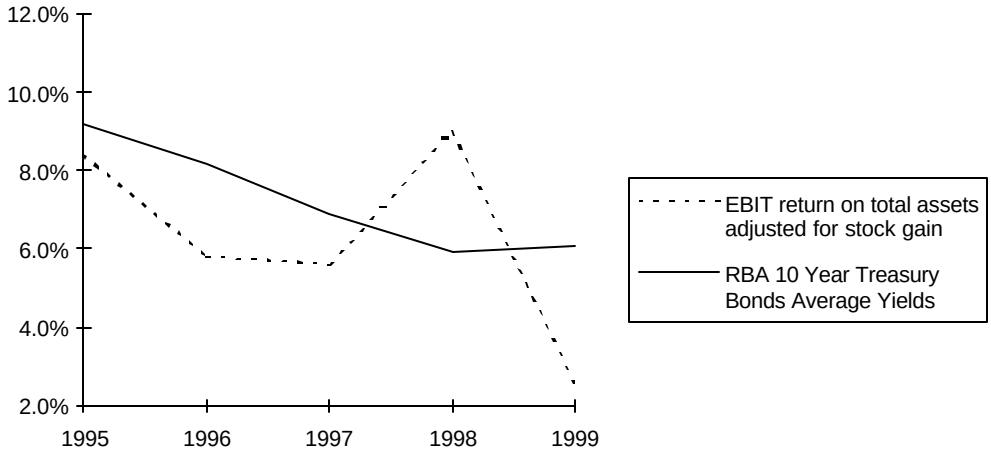
Losses have been made from Refining activities, while the Marketing segment has been profitable

Underlying Net Profit per Litre
(net profit after tax adjusted for stock gains/losses)



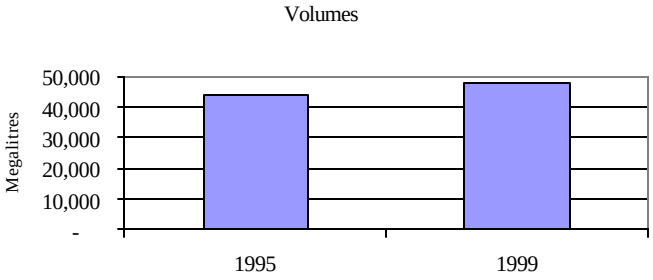
Profits during the Survey period have been 1 cent per litre or less

Earnings Before Interest & Tax Return on Average Total Assets

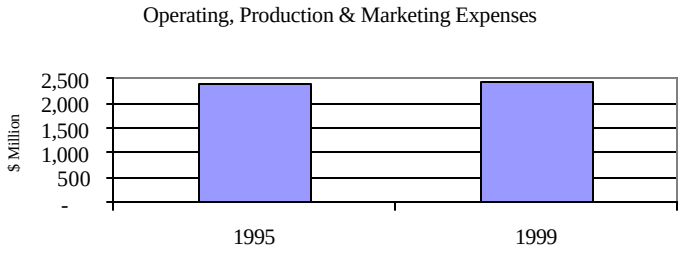


Underlying profitability has again fallen below the bond rate

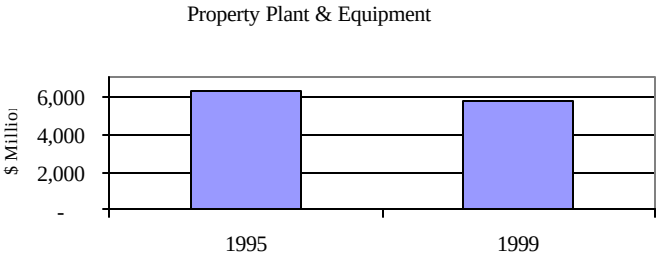
DOWNSTREAM OIL INDUSTRY EFFICIENCY GAINS



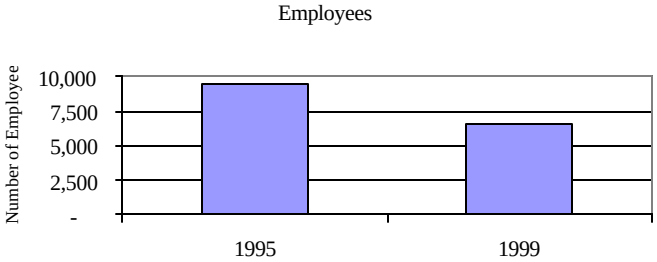
Sales volumes have increased by 9%



Operating costs (excluding crude oil) have remained static. Unit costs have fallen by 7%, reflecting efficiency gains

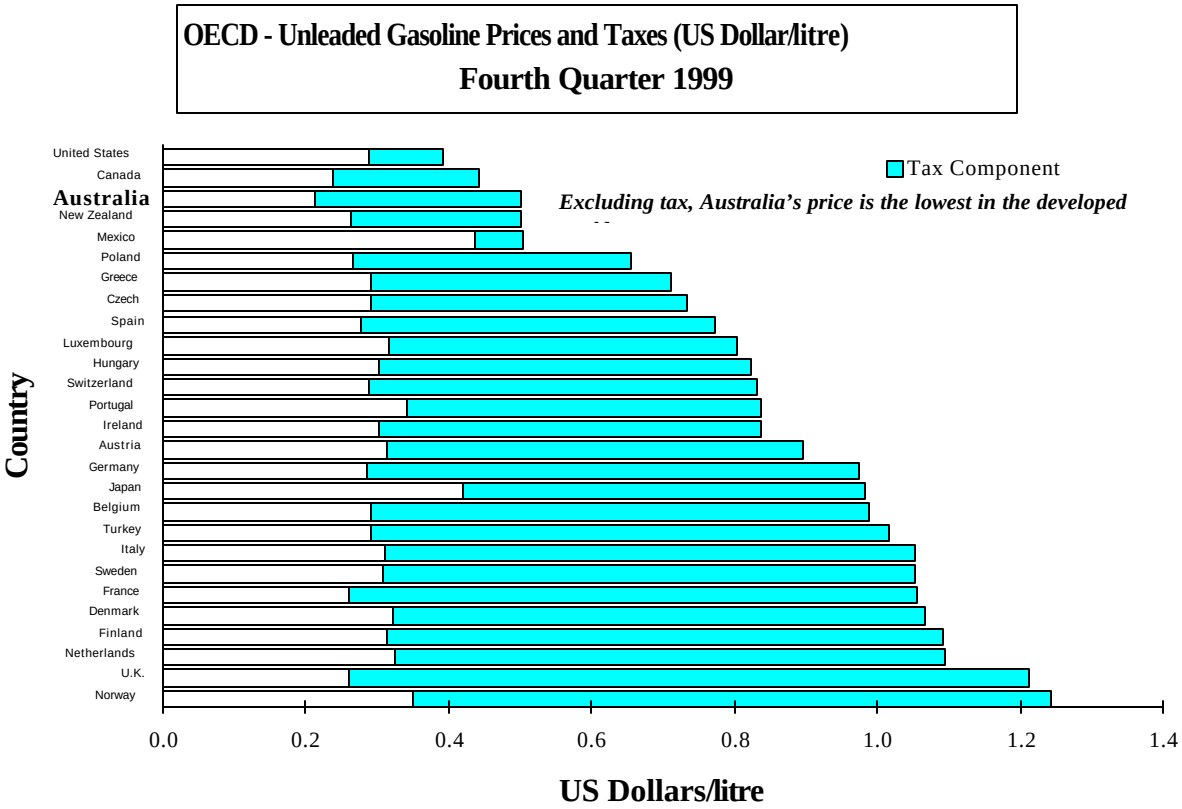


Property, plant & equipment has fallen by 8% reflecting an increase in capital efficiency



Employee numbers have fallen by 31% reflecting increased labour efficiency

While the industry has made significant efficiency gains in the past five years, profit per litre has remained relatively static (as illustrated on the preceding page). The benefit of these gains has been passed on to the consumer.



Source: International Energy Agency Statistics, Fourth Quarter,

TABLE 1: KEY SALES AND FINANCIAL DATA

	1995	1996	1997	1998	Average 1995-98#	1999
			Megalitres			
Domestic sales volume	38,691	39,973	40,349	40,174	39,797	40,912
Export sales volume	5,102	6,185	6,982	7,021	6,323	6,867
Total sales volume	43,793	46,158	47,331	47,195	46,120	47,779
Refined product volume imported from overseas	n/a	n/a	n/a	2,038	n/a	2,776
			$ Million			
Gross sales revenue	23,084	25,139	25,641	23,989	24,463	24,730
Duties and taxes	11,069	11,937	11,750	11,737	11,623	12,025
Net sales revenue	12,015	13,202	13,891	12,252	12,840	12,705
Stock gain/(loss)	*60*	*207*	*(204)*	*(348)*	*(71)*	*703*
Earnings before interest and tax	892	807	387	535	655	966
ADJUSTED FOR STOCK GAIN/(LOSS)	*832*	*600*	*591*	*883*	*727*	*263*
Net profit after tax	366	355	82	262	266	671
ADJUSTED FOR STOCK GAIN/(LOSS)	*327*	*223*	*212*	*484*	*312*	*221*
Net profit return on average shareholders' funds	8.0%	8.4%	2.0%	7.0%	6.4%	17.3%
ADJUSTED FOR STOCK GAIN/(LOSS)	*7.2%*	*5.2%*	*5.2%*	*13.0%*	*7.8%*	*5.7%*
Earnings (before interest and tax) return on average total assets	9.0%	7.7%	3.7%	5.4%	6.5%	9.6%
ADJUSTED FOR STOCK GAIN/(LOSS)	*8.4%*	*5.8%*	*5.6%*	*9.0%*	*7.3%*	*2.6%*
Total payments to governments	11,446	12,254	12,323	12,639	12,166	12,897
Shareholders' funds	4,165	4,298	3,748	3,682	3,973	4,061
Total borrowings	3,861	4,286	3,775	3,031	3,738	3,169
Total funds employed	8,026	8,584	7,523	6,713	7,713	7,230
Debt to equity ratio	93%	100%	101%	82%	94%	78%
Total assets	10,099	10,765	10,265	9,427	10,139	10,687
New investment	636	632	433	386	522	408
Environmental expenditure (both operating and capital)	177	121	96	101	124	139

\# Calculated as the average of the previous four years' individual figures
n/a Data not available

Segment Information 1999:	**Refining**	**Marketing**	**Consolidated**
Net profit/(loss) after tax, $ million	389	282	671
ADJUSTED FOR STOCK GAIN, $ million	*(61)*	*282*	*221*

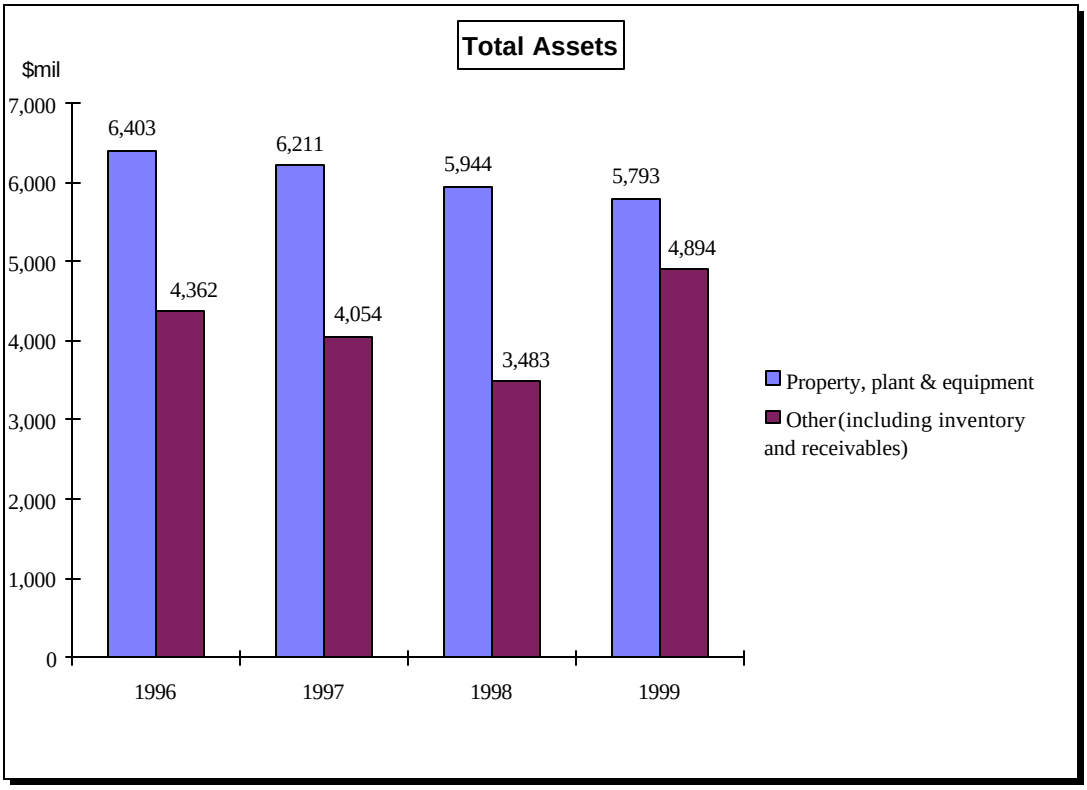
BALANCE SHEET

The carrying value of the industry's total assets has exceeded $10.6 billion at 31 December 1999, compared with $9.4 billion in the prior year. This increase has been driven by the increase in working capital arising as a result of increased crude oil prices.

Against this increase, capital invested in property, plant and equipment has been reduced to $5.8 billion, maintaining the downward trend from 1996. Depreciation and asset rationalisation have exceeded the rate of new investment in the industry during this period of low profitability.

Total borrowings, which had been decreasing since 1996, have increased to almost $3.2 billion as a result of low cash returns from operating activities.

Over half of the industry's assets are held in the Marketing segment, reflecting the depreciated base of the Refining segment.



Property, plant and equipment is being rationalised

TABLE 2: BALANCE SHEET

Historical cost	1995	1996	1997	1998	1999
			$ Million		
CURRENT ASSETS					
Cash	157	95	87	45	4
Receivables	1,655	1,855	1,853	1,569	1,984
Inventories	1,502	1,824	1,563	1,167	2,098
Other current assets	129	199	167	171	135
TOTAL CURRENT ASSETS	3,443	3,973	3,670	2,952	4,221
NON CURRENT ASSETS					
Property, plant & equipment	6,309	6,403	6,211	5,944	5,793
Receivables	70	77	80	72	142
Other non current assets	277	312	304	459	531
TOTAL NON CURRENT ASSETS	6,656	6,792	6,595	6,475	6,466
TOTAL ASSETS	10,099	10,765	10,265	9,427	10,687
CURRENT LIABILITIES					
Borrowings	1,517	2,204	2,128	1,815	2,044
Creditors and accruals	1,260	1,288	1,849	1,470	2,270
Provisions	264	226	226	413	365
Income tax	71	104	65	92	129
Other current liabilities	8	25	51	9	55
TOTAL CURRENT LIABILITIES	3,120	3,847	4,319	3,799	4,863
NON CURRENT LIABILITIES					
Borrowings	2,344	2,082	1,648	1,216	1,125
Creditors and accruals	1	9	0	0	0
Provisions	52	65	215	221	136
Income tax	409	423	275	341	325
Other non current liabilities	8	41	60	168	177
TOTAL NON CURRENT LIABILITIES	2,814	2,620	2,198	1,946	1,763
TOTAL LIABILITIES	5,934	6,467	6,517	5,745	6,626
Shareholders' funds	4,165	4,298	3,748	3,682	4,061
TOTAL EQUITY & LIABILITIES	10,099	10,765	10,265	9,427	10,687

Balance Sheet Analysis by Segment for 1999 *Averages for the 12 months*	**Refining** **$ Million**	**Marketing** **$ Million**	**Consolidated** **$ Million**
Average total assets	4,595	5,462	10,057

PROFIT & LOSS STATEMENT

The downstream oil industry has experienced a fall in underlying profitability (i.e. profit after adjusting for stock gains due to crude oil price rises) in 1999. Underlying profit after tax for the year was $221 million, a decrease of $263 million from the prior year.

The underlying return of earnings before interest and tax on average total assets was 2.6%, being the lowest of the current five year Survey period, and in fact the lowest since 1992. This return continues to be inadequate for an industry with gross revenues of almost $25 billion and total assets of more than $10 billion.

The industry remains unable to achieve adequate levels of profitability. Major factors have been the high levels of competition within the industry, the over supply of petrol and diesel in the Asian region, and the very low refining margins internationally. For several months of 1999, refining margins were negative, indicating that the market price of refined product had fallen below the cost at which product could be manufactured locally. This is a consequence of the excess refining capacity in the region.

Operating, marketing and production expenses have been reduced by $37 million from the prior year despite increased sales volumes, indicating continued improvements in efficiency and the utilisation of assets.

Sales volumes and gross sales revenues recovered in 1999, while still not reaching the levels of 1996 and 1997. However, of the $741 million increase in gross sales revenue, $288 million was passed on to the government by way of increased excise duties and sales tax. This expense has now exceeded $12 billion for the first time since this Survey began.

Statutory accounting profits include stock gains and losses arising from fluctuations in the price of crude oil over a year. Over the course of 1999, the crude oil price increased from US$12/barrel to US$25/barrel. These fluctuations are estimated to have increased earnings by $703 million. The favourable impact on results arising from increased stock values reverses when crude oil prices fall. The movements in crude oil and international product prices over the Survey period are shown in Appendix 1.

Statutory accounting profit after tax has also been impacted favourably by the recently announced reductions in future income tax rates. This announcement has required the participating companies to recalculate deferred tax balances, which in the current year has produced an income tax benefit of $86 million. For the purposes of this Survey, this benefit has been reported as an extraordinary item. Against this benefit, there has been an extraordinary charge of $14 million in respect of restructuring.

Analysis of the Refining and Marketing Segments

For the 1999 year, data has been collected from the participating companies to show the relative profitability of the Refining and Marketing segments of the industry. This data is presented in Table 3a.

While both segments returned profits on a statutory accounting basis, the Refining result was impacted favourably by the stock gain of $703 million during the year. Without this accounting benefit, the Refining segment would have reported a loss before extraordinary items of $132 million, and a negative return of earnings before interest and tax on average total assets of (6.6%). This level of return is unsustainable.

The Marketing segment returned a profit of $282 million, or 1.1% of gross sales revenue. These results are indicative of the high competition and low margins in the Marketing segment of the industry.

TABLE 3: PROFIT & LOSS STATEMENT

	$ Million				
	1995	**1996**	**1997**	**1998**	**1999**
Gross sales revenue	23,084	25,139	25,641	23,989	24,730
Less excise duties, State/ Territory franchise fees and sales tax *	(11,069)	(11,937)	(11,750)	(11,737)	(12,025)
Net sales revenue	12,015	13,202	13,891	12,252	12,705
Net non-fuel revenue	338	295	416	456	338
Cost of petroleum inputs	(8,643)	(9,896)	(10,913)	(9,262)	(9,219)
GROSS MARGIN	3,710	3,601	3,394	3,446	3,824
Depreciation	428	431	443	450	433
Other operating, marketing and production expenses	2,390	2,363	2,564	2,461	2,424
Stock gain/(loss)	*60*	*207*	*(204)*	*(348)*	*703*
EARNINGS BEFORE INTEREST AND INCOME TAX	892	807	387	535	966
ADJUSTED FOR STOCK GAIN/(LOSS)	*832*	*600*	*591*	*883*	*263*
Interest expense	(258)	(300)	(269)	(186)	(177)
EARNINGS BEFORE INCOME TAX	634	507	118	349	789
ADJUSTED FOR STOCK GAIN/(LOSS)	*574*	*300*	*322*	*697*	*86*
Income tax on earnings	(206)	(152)	(59)	(87)	(190)
Adjusted for stock gain/(loss)	*(185)*	*(78)*	*(133)*	*(214)*	*63*
PROFIT AFTER INCOME TAX	428	355	59	262	599
ADJUSTED FOR STOCK GAIN/(LOSS)	*389*	*223*	*189*	*484*	*149*
Net extraordinary items	(62)	0	23	0	72
PROFIT AFTER EXTRAORDINARY ITEMS	366	355	82	262	671
ADJUSTED FOR STOCK GAIN/(LOSS)	*327*	*223*	*212*	*484*	*221*

* In August 1997, state and territory franchise fees were effectively invalidated by a High Court decision. The Commonwealth, state and territory governments agreed to replace franchise fees with an excise surcharge, with the surcharge proceeds being returned to the states and territories.

TABLE 3a: PROFIT & LOSS STATEMENT - Refining v Marketing in 1999

		$ Million	
	Refining	**Marketing**	**Total**
Gross sales revenue	10,625	24,730	24,730
Less excise duties, State/Territory franchise fees and sales tax		(12,025)	(12,025)
Net sales revenue	10,625	12,705	12,705
Net non-fuel revenue		338	338
Cost of petroleum inputs - Crude	(9,219)		(9,219)
Cost of petroleum inputs - Product		(10,625)	
GROSS MARGIN	1,406	2,418	3,824
Depreciation	204	229	433
Other operating, marketing and production expenses	802	1,623	2,424
Stock gain/(loss)	*703*	-	*703*
EARNINGS BEFORE INTEREST AND INCOME TAX	400	566	966
ADJUSTED FOR STOCK GAIN/(LOSS)	*(303)*	*566*	*263*
Interest expense	(15)	(162)	(177)
EARNINGS BEFORE INCOME TAX	385	404	789
ADJUSTED FOR STOCK GAIN/(LOSS)	*(318)*	*404*	*86*
Income tax on earnings	(67)	(123)	(190)
Adjusted for stock gain/(loss)	*186*	*(123)*	*63*
PROFIT AFTER INCOME TAX	318	281	599
ADJUSTED FOR STOCK GAIN/(LOSS)	*(132)*	*281*	*149*
Net extraordinary items	71	1	72
NET PROFIT AFTER EXTRAORDINARY ITEMS	389	282	671
ADJUSTED FOR STOCK GAIN/(LOSS)	*(61)*	*282*	*221*

Earnings (before interest and tax) return on average total assets	8.7%	10.4%	9.6%
ADJUSTED FOR STOCK GAIN/(LOSS)	*(6.6%)*	*10.4%*	*2.6%*

CASH FLOW, INVESTMENT & DIVIDENDS

Cash from operating activities in 1999 has been $220 million, which is the lowest in the Survey period. In order to finance increased stock levels, capital investment and returns to shareholders, borrowings increased by $138 million from the prior year end.

Although the industry has been experiencing marginal volume growth over the period, substantial on-going investment has been required to meet the demands of continuing technological change, operational efficiency improvements and increasingly costly environmental requirements.

As a result and despite low profitability over the five year period, the industry has invested almost $2.5 billion since 1995 for the upgrading of property, plant and equipment (refer to Table 1). In the foreseeable future, government requirements for cleaner fuels will result in the need for further increased investment to allow for these added requirements to be met.

Capital investment in 1999 has included $192 million invested in refining assets. Of this amount, approximately $89 million was unavoidable capital expenditure made for technical reasons of replacement or to meet regulatory requirements. Much of the remaining $103 million was the result of decisions taken some years previously.

TABLE 4: NET CASH FLOW

	$ Million				
	1995	**1996**	**1997**	**1998**	**1999**
Cash from operating activities and working capital items	800	266	1,717	1,329	220
Dividends paid	(436)	(256)	(251)	(188)	(327)
Net cash from investing activities	(498)	(501)	(205)	(492)	(108)
	(134)	(491)	1,261	649	(215)
Cash from financing activities					
• Equity raisings	0	0	0	0	0
• Additional borrowings/(repayments)	501	429	(1,269)	(727)	138
• Other financing activities	(310)	0	0	33	36
	191	429	(1,269)	(694)	174
Net cash flow	57	(62)	(8)	(45)	(41)

PAYMENTS TO GOVERNMENTS

Annual payments made to governments have increased by more than $1.6 billion over the five years of the Survey period.

By far the majority of these payments, $12.7 billion in 1999, were to the Federal Government for excise duties on products. The duty rates vary widely across products.

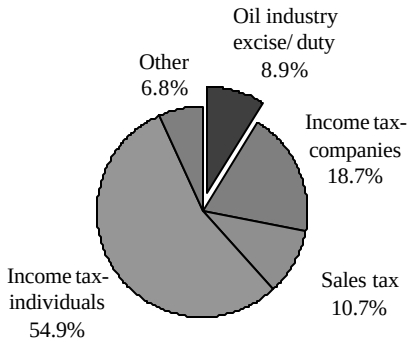
Excise duties from the industry alone represented 8.9% of the total taxation revenue received by the Federal Government during the 1998-99 fiscal year, making the downstream oil industry a significant contributor to Federal Government revenue. This tax is ultimately borne by the consumer. Sales tax payments of $25 million represent the amounts charged in respect of non-fuel sales.

Following the 1997 change in the excise taxation regime, the industry has received and passed on to the consumer state fuel subsidies totalling $701 million in 1999.

TABLE 5: PAYMENTS TO GOVERNMENTS

	$ Million				
	1995	**1996**	**1997**	**1998**	**1999**
Excise duty / state & territory franchise fees (gross)	11,025	11,898	12,029	12,382	12,701
Sales tax	44	39	34	35	25
Sub total	11,069	11,937	12,063	12,417	12,726
Income tax payments	220	165	118	61	14
Land tax and rates	81	81	78	75	68
Payroll tax	38	38	36	37	35
Fringe benefits tax	25	24	21	23	23
Withholding tax	3	1	1	17	22
Others	10	8	6	9	9
Sub total	377	317	260	222	171
Total	11,446	12,254	12,323	12,639	12,897

Oil Industry Excise Duty Contributions to Federal Government Revenue



SOURCE: Budget Strategy & Outlook 1999-2000 Budget Paper No.1 p. 6-3 (1998-99 Estimate figures)

Duties and taxes on petroleum products contribute over $12 billion to government revenue

EMPLOYEES

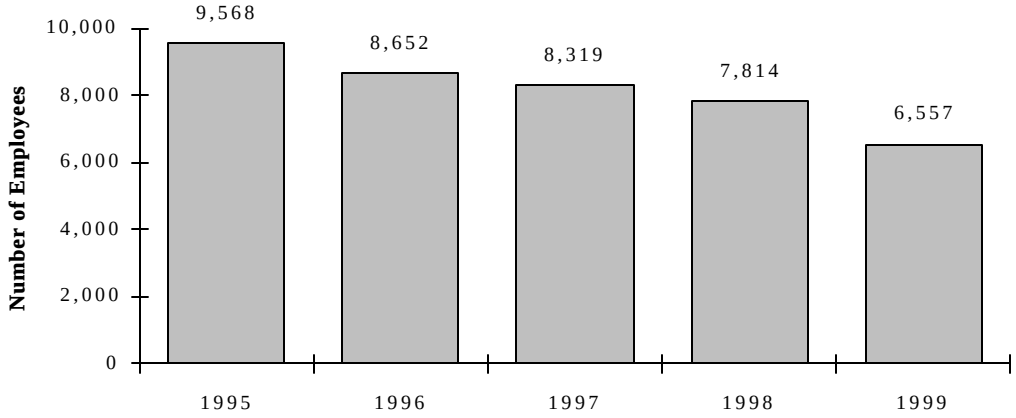
Despite continued rationalisation over recent years, the downstream oil industry continues to be a major employer. The refiner marketing companies directly employed 6,557 people at 31 December 1999, and indirectly employ substantially greater numbers in retail and other wholesale sectors of the industry. The number of people directly employed represents a reduction of 31% from 1995.

Of the 6,557 employees at 31 December 1999, 2,912 (or 44%) were employed in the Refining sector, and 3,645 (or 56%) were employed in the Marketing sector.

The declining number of employees reflects the competitive nature of the industry and the continuing search for operational efficiencies.

The figures quoted represent only those people directly employed by the refiner marketing companies. Contractor resources, which are largely used in the Refining segment, are not included. In addition, an estimated 36,000 people are employed by distributor companies and site franchisees.

Total Employees on Payroll



EXPLANATIONS AND DEFINITIONS

Refining and Marketing Segments

For the purposes of this Survey, the Refining segment is deemed to include all assets within the refinery fence, and all activities directly involved in the production of refined petroleum product. The Marketing segment includes all assets and activities involved in the distribution, storage and sale of refined petroleum product.

Accounting Policies

The aggregated historical industry data is a summation of company results consistent with their latest financial statements relevant to the Survey period.

Prior Year Adjustments

Financial information reported in prior years is restated where necessary to present the information in a comparable and consistent manner.

Rounding

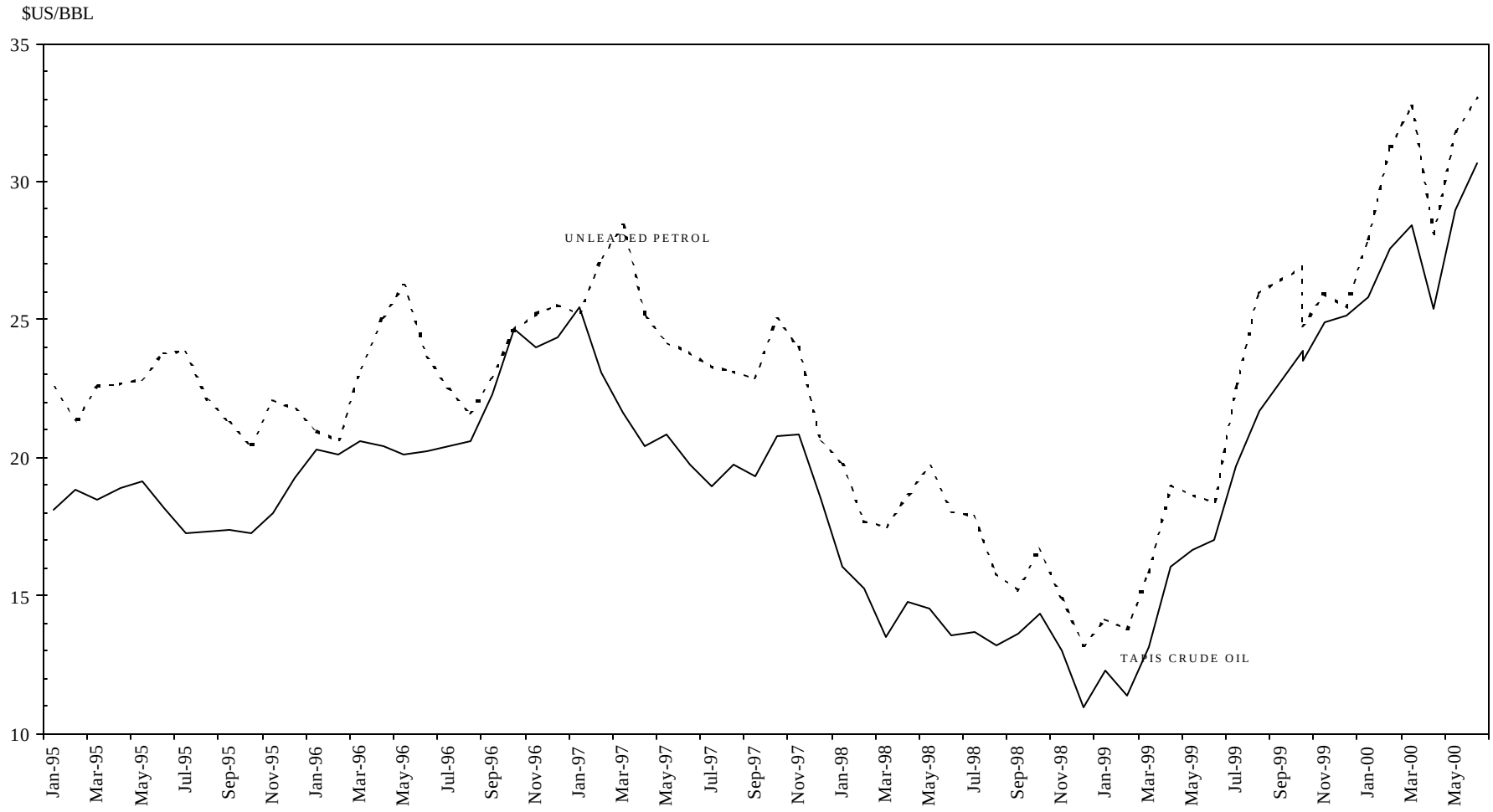
The monetary amounts and ratios in the Survey tables have been rounded to the nearest million dollars or one decimal place for percentages.

Formulas and Ratios

Funds Employed	Sum of shareholders' funds and total current and non current borrowings
Debt to Equity Ratio	$\frac{\text{Total current and non current borrowings}}{\text{Total shareholders' funds}}$
Net profit return on average shareholders' funds	$\frac{\text{Net profit}}{\text{Average of shareholders' funds at the beginning and end of the period}}$
Earnings before interest and taxes return on average total assets	$\frac{\text{Earnings before interest, taxes and extraordinary items}}{\text{Average of total assets at the beginning and end of the period}}$

APPENDIX 1

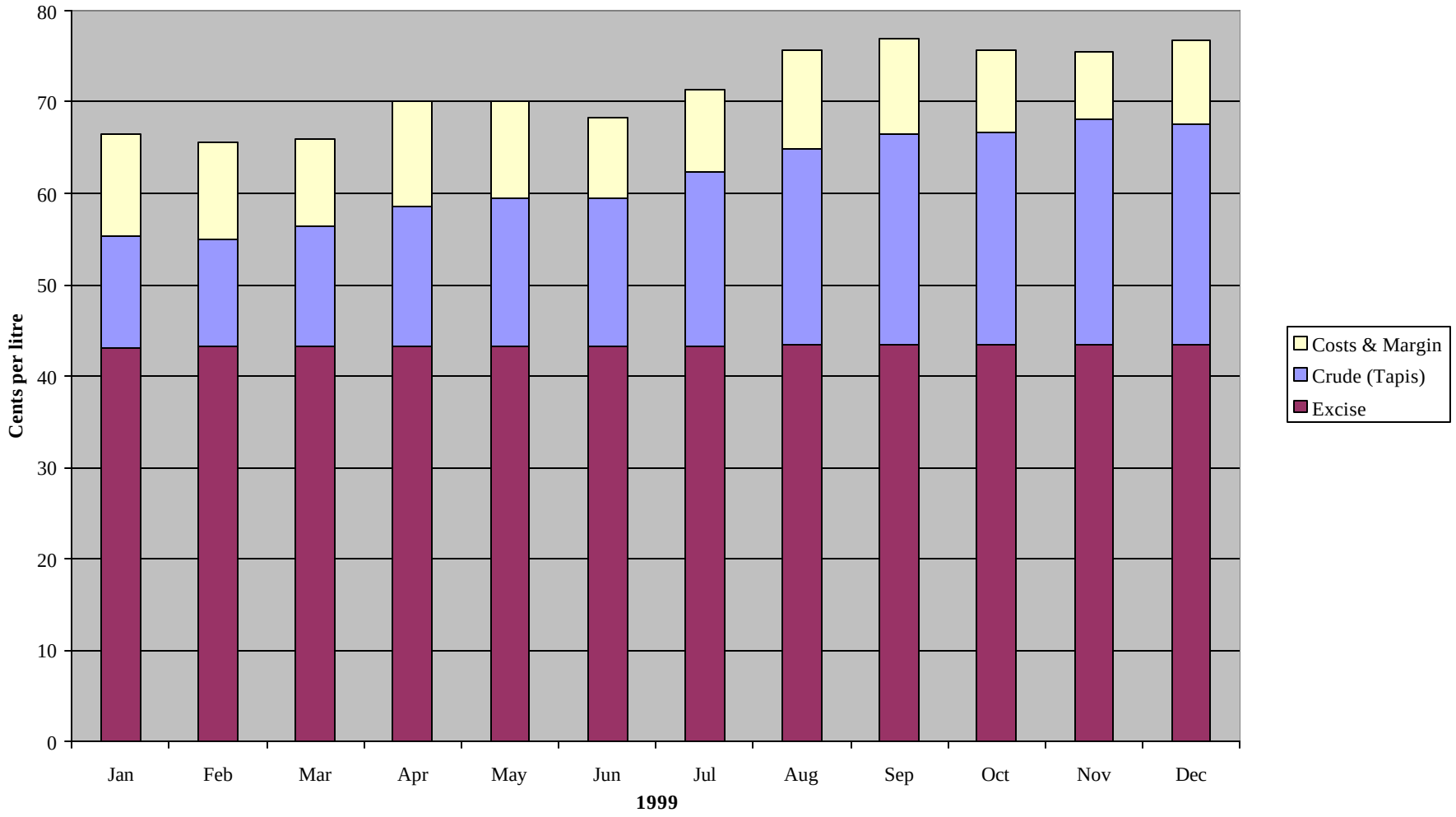
Crude Oil and Unleaded Petrol International Price Movements in $US



Source: Bloomberg (APCRTAPI, MOGFC95S)

Components of Pump Price

(Sydney Metropolitan Monthly Average)



Source: Informed Sources Pty Ltd