TRANSCRIPTION

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[START OF TRANSCRIPT]

Operator: Thank you for standing by, and welcome to the Viva Energy Australia government fuel security package conference call. All participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. If you wish to ask a question, you will need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr. Scott Wyatt, Chief Executive Officer and Managing Director. Please go ahead.

Scott Wyatt: Yeah, good morning, and thank you all for joining us on this call to discuss the federal government's fuel security package that was announced this morning. My name's Scott Wyatt. I'm the CEO and managing director. With me is Jevan Bouzo, our chief operating and financial Officer, and Lachlin Pfeiffer, our chief business development and sustainability officer.

Over the last 12 months, we've been working closely with the federal government to establish a framework which addresses the headwinds faced by the Australian refining sector, and improves long-term confidence to underpin continued operations and investment in Geelong Refinery, which in turn protects the country's energy security.

The fuel security package announced this morning achieves this by providing material support during periods of low refining margins, effectively reducing Geelong Refinery's breakeven margin, while preserving the opportunity for Viva Energy to extract a fair return on investment as refining margins recover and as continued improvements in operating performance are achieved.

The package also includes a significant contribution to upgrade the refinery, to improve fuel standards and reduce vehicle emissions. It also includes an option for the company to extend the arrangements for an additional three years beyond the initial six years of the programme. This provides sufficient long-term certainty, which is necessary to make these investments.

The fuel security package consists of three main elements. The fuel security services payment provides a payment of up to 1.8 cents per litre on actual production of main-grade fuels. The payment is determined in reference to a margin marker, which has been developed separately for each refinery and comprises public markets for crude, product, and freight, which has been adapted to Geelong's operations.

Payment under the structure will commence when the margin market falls below $10.20 per barrel, Australian dollars, and increases from 0 cents per litre to 1.8 cents per litre on a linear basis as the margin marker falls to Australian $7.30 per barrel. The margin marker has been designed to support the Geelong Refinery when the refining margin is below the long-term cash breakeven level, inclusive of all operating costs and an average capital expenditure.

The lower breakeven level effectively reduces the risk of accumulating cash losses from refining operations during sustained periods of low refining margins. The second aspect of the fuel security package is an introduction to minimum stock holding obligations for petrol, diesel, and jet fuel for companies that import fuel into Australia.

The first stage is expected to commence in July, 2022, and is designed to maintain current average product levels in Australia. The second stage is expected to commence in July, 2024, and will require a 40% increase in holdings of diesel nationally, lifting consumption days coverage to about 28 days.

The structure of the minimum stock holding obligations will apply to Viva Energy. However, refineries are expected to be exempt from the increased stock holding requirements. In addition, the crude we hold at Geelong will be counted towards the holding requirements on a notional converted basis. We expect that a secondary trading market will develop in time to allow the trading of surplus storage with those companies that have increased storage requirements.

The third aspect of the fuel security package is the requirement to bring forward the introduction of ultra-low sulphur gasoline from mid-2027 to end-2024, and to assess other potential petrol and diesel specification changes, which support further harmonisation with Euro 6 vehicle emission standards.

The federal government will provide a 50% contribution up to $125 million towards the capital upgrades required at Geelong Refinery to produce low-sulphur gasoline, and a further $26 million to support any additional changes to fuel specifications if they are agreed. We have long supported continued improvement in Australian fuel standards that result in better health and environmental outcomes, and welcome this material support for the investments which are required to achieve these upgrades.

For Viva Energy to receive the benefit of the fuel security package, the federal government is seeking out commitment to operate the refinery through to 30th of June, 2027, with an option for the refineries to extend the package for an additional three years. At the conclusion of the first two years, both industry and federal government will review the performance of the margin-market mechanism, the impacts of the minimum stock holding obligations, and the outcome of the aromatic fuel specification review to ensure that the package is delivering the benefits that are expected.

However, all this is a balanced package that helps protect the energy security requirements of government, while providing the refining sector the level of long-term certainty necessary to retain operations and make ongoing investments to improve fuel standards and operating performance. We welcome today's announcement and thank Minister. Taylor's department for their support.

We have committed to participate in this package, subject to the final terms and ultimate approval of the legislative package. While other refining business have been heavily impacted by the pandemic, it remains a fundamentally solid business with prospects to make a material earnings contribution to Viva Energy, as fuel demand recovers in the period ahead.

This package reduces the downside risk of operating through an uncertain period, while preserving the opportunity to benefit from any recovery and refining margins. And this will help to underpin the transformation of our site into a broader energy hub. Continued refining is a great outcome for our people, shareholders, and the broader Geelong community, and we appreciate the patience and support that we have received through the last year as this package was developed. I'd like to now open up the call for questions.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speakerphone, please pick up the handset to ask your question. Your first question comes from Mark Samter with MST Marquee. Please go ahead.

Mark Samter: Morning Guys. Congrats on what's a great deal. I just had a quick question kind of around the minimum stock holding obligations. I guess just a starting point. Do you have a feeling on that? We're obviously very important to importer, but kind of in its totality, what current stock holdings would be, in terms of the quantum of pain those guys are going to feel, because I mean, it certainly feels to me like, I guess, rightly, given what you and AMPOL is committed to for the country and the refining industry, you guys are in an incredibly strong relative position to those who are pure importers.

Scott Wyatt: I'll get Lachlan to address that, Mark.

Lachlan Pfeiffer: Hi, Mark. It's Lachlan Pfeiffer. Look, I mean, from a first point, obviously, there's a lot of detail to come on the MSO. So I think that the detail of how it will be implemented will be important, and we're to work through all of that in the next few months. But broadly, the government has set the initial holdings on an average basis for industry at what is considered to be the current holdings. So the 24 and 20-day holding levels that are commencing from 1 July, '22, or are designed to be maintaining existing average holdings across the industry at the moment. And then, the increase comes with the 40% increase in 1 July, 2024 for the diesel stock holdings.

Mark Samter: Okay, thank you. And then just a question for, I dont know if this is for you Scott or Jevan, but with what's going to be where this will be set this last year, a much higher almost guaranteed set of earnings, but certainly more visibility and less volatility to in it. You're going to be running a... you'll probably say conservative, I'd say very lazy balance sheet very quickly. Can you give us any stir on the range of opportunities you see for that balance sheet capacity?

Jevan Bouzo: Yeah, I can take that one Mark. It's Jevan here and thanks for the question. I think definitely over the past 12 months or so we've talked about the uncertainty in refining causing us to be a little more cautious, particularly around the balance sheet and our outlook generally and for investment in the business and the package that we've announced today, I think really deals with a lot of that refining uncertainty. It gives us confidence through the commitment periods and you obviously see that from the release. I think from a balance sheet perspective it gives us the opportunity to think a little bit more broadly around the level of investment that we feel confident to make both in Geelong, the broader energy hub site and in new energy and new business opportunities and really sets the foundation for us to do more on that in the near term. And so as you say, I think it's a great outcome for the refinery and definitely opens up some balance sheet capacity for us to continue to invest in the business.

Mark Samter: Perfect. Thanks.

Operator: Thank you. Your next question comes from Michael Simotas with Jefferies. Please go ahead.

Michael Simotas: Good morning, everyone. And again, it's a great deal. Well done. Can I just follow on from Mark's question around the balance sheet Jevan? So it sounds like you're sort of thinking more about this gives you flexibility to pursue investment opportunities. Do you think there'll be any headroom to potentially return some capital to shareholders?

Jevan Bouzo: Yeah I think that's always an option. It's probably not always our first preference and I think we've got a pretty good range of investment opportunities across the business. When you think about the energy hub, some of the works that we're going to be able to do at Geelong on the back of this package. And we've always said to the market that we'd be open to continuing to invest in the business, but from an acquisition opportunity perspective, but also a new energies and new business opportunity perspective. And in the event that we've got excess capacity in the balance sheet and we can't find a good use for that capital then we've demonstrated that we're pretty open to returning that to shareholders, if that's the best use of that money.

But I think at this stage we're really pleased to have this package in place. We think it gives us a lot of certainty for refining earnings and that part of the business going forward and should at least enable us to open up some additional balance sheet capacity. What exactly we do with those funds over time I think it's still to be worked through, but I would point out that we've got a pretty exciting opportunity for investment and growth in the business and the site going forward. And that'll be our first and foremost focus at this stage and, as we've done in the past, if sensible opportunities don't arise, then returning money to shareholders always remains an option.

Michael Simotas: That makes sense. Thank you. And then the second question I've got is just; can you talk about the financial implications of the closure of other refineries in Australia? I guess for you the biggest potential impact could be availability of local feed stocks?

Scott Wyatt: Scott here. Yeah I think as you know Geelong processes currently about a third of its diet from local indigenous crudes and that's a feature of our location, I guess. And with other local refineries closing it should most likely make the availability of those crudes more available to us, but we always assess those relative to all the options that we've got and make obviously the best economic decision. So that won't always drive you to the local crudes that will also drive you to exploit other crudes that are available around the region as well as they're more attractive. So I think it's one of those things that we always take a sensible economic decision on.

Michael Simotas: Okay. Thank you.

Operator: Thank you. Once again, if you wish to ask a question, please press star one. Your next question comes from David Errington with Bank of America. Please go ahead.

David Errington: Morning Scott. Morning Jevan. Yeah, we thank Angus Scott, as you said, you thank Angus and Mr. Morrison for the package. And the shareholders, we thank them too. But on the answer to Mark's original question on the storage, I didn't really fully follow the answer that you gave. I mean, I think the question was what competitive advantage will it now be to refiners and this trading environment that you're talking about? We're trying to get an understanding as to what impact that's going to have on the refining margin. It should improve it, I would imagine with the 40% increase in diesel requirements by 24. So we'd like a little bit of understanding as to what in dollars and cents, how much of a competitive advantage that's going to be obviously to Geelong with excess storage capacity and probably Lytton as well. So, and that's relative to a pure importer rather than someone that's going to convert. But can you give us a little bit more colour? Because I didn't really follow the answer that you gave, I didn't think you really gave us that much.

Scott Wyatt: David, because I think that's we actually it's hard to describe a value to it yet because it's some way off and the details are not, they still need to be developed. And ultimately the value of MSOs to the refinery will depend ultimately on the workings of the market at the time, which is hard to predict. So, overall, I think it should benefit refiners in the sense that we're were not obliged to meet the increase in diesel storage requirement stock holdings within the refining system. So that's an advantage when we get to count the crude on a notional basis towards our product storage as well. So we will be impacted by locations where we need to import but we obviously can offset that with our position at the refinery. So we feel pretty well placed to deal with the MSOs, but in terms of what benefit that ultimately ascribes to, we just have to wait and see.

David Errington: You just negotiated $2 billion package Scott. I reckon you'd have a fair idea of what the advantage is, but you just don't want to tell us yet. That's probably more the point isn't it?

Scott Wyatt: It's four years ago. It's three and a bit years away, David. We just need to wait and see before the increase in diesel storage requirements come into play. So we just need to wait.

David Errington: Okay. No, fair call, fair call. The second point. Can you give us a little bit... I mean this is a bit of maintenance stuff. But, I'm really pleased that the package covers cash costs which includes your CAPEX as well. Can you give us a bit in... last year was a difficult year because production was low and production was impacted because of jet and et cetera. But through the cycle, what would Geelong's cash costs be from an operating perspective and through the cycle, what would you CAPEX, all on a per barrel basis? What would you be looking at so as we've got a bit of an idea as to how much this package covers.

Jevan Bouzo: I can cover that, David. It's Jevan here. So there's two ways to think about that and if you track through some of our full year results presentations, I think it was slide 32 at the most recent presentation, gives you a good guide as to what the operating cost profile looks like. And broadly speaking in Aussie dollar terms, if you look at last year or the earlier years as an example, operating costs in Aussie dollars per barrel were around $7 per barrel at the refinery. CAPEX is then over and above that, and when you think about CAPEX through the cycle, we've had a maintenance CAPEX in previous years of around that $50 million, 50 to $60 million a year level. And there's a couple of major turnarounds. Our cat cracking turnaround, which has historically been around 110 to 140 million, and the CDUs for turnaround of about 75 and they tend to relate to a four and six year period.

And then there's also the low sulphur fuel investment over that period too. So if you average that through the cycle, you probably get to around $2 a barrel Aussie or so, maybe a little more and bear in mind that in the context of the low sulphur fuel investment, that we'll have to make during the commitment periods, part of that is covered through the government grants programme and the other part will have to be recovered through the support mechanism that we've got in place. So I think you're right. From a support perspective at the $10.20 threshold, when that kicks in, that takes account of our operating earnings and all of the capital that we have to recover through the commitment periods and is part of the reason why we get confidence to run for this time with the package in place.

David Errington: So your $7 per barrel Aussie for operating, that's a cash operating cost, or is that, that's including depreciation?

Jevan Bouzo: That's a cash operating cost, David, in a EBITDA context.

David Errington: Yeah. So you're running at about, roughly $2 a barrel with CAPEX plus $7 a barrel cash operating. And it kicks in at $10.20. So you're pretty well covered from a cash operating perspective through the cycle. So it's a very nice package for you from a cash earnings perspective. That's the way you think about it?

Jevan Bouzo: Yeah, that' right David, and we've focused pretty strongly on the cash earnings and through the period of discussion with the government obviously EBITDA is widely reported, but the CAPEX can't be ignored and it is there. And so in an industry like that, being able to cover our cash expenditure has been pretty important. And I think as you say, a good outcome, that the governments recognise that in the context of the package that's been put in place.

David Errington: Yeah. You reduce your volatility of earnings, you get your cash support, you get your CAPEX provided. It's just a fantastic package. I'm wondering what the catch to all of this is, but well done. Great deal.

Jevan Bouzo: Thanks, David.

David Errington: Thanks, Scott, thanks, Jevan.

Operator: Thank you. Your next question comes from Joseph Wong with UBS. Please go ahead.

Joseph Wong: Morning, guys. Just in regards to, I guess the refinery and the energy hub. So now that the government has taken some of the volatility from the refinery, how does that impact your risk appetite for the LNG input? Would you be looking to take commodity exposure on that end and how is that discussion happening with your partners, with Vitol and Engie?

Scott Wyatt: It's a very much standalone project. There is some, obviously, some inter-relations with the other projects that Geelong include in the refinery and there's a bunch of synergies that come from operating the LNG import facility alongside the refinery, particularly in terms of managing water. But I think from a commercial perspective and how we think about it, this outcome for refining doesn't necessarily change our risk appetite for the LNG facility. That's will be a standalone decision. And obviously it will depend on how we decide to take it forward with the partners that are involved in that. So that remains to be seen. It'll be obviously the decision we take when we move to... We'll hopefully move to FID in the first half of next year.

Joseph Wong: Great, thanks.

Operator: Thank you. Your next question comes from Baden Moore with Goldman Sachs. Please go ahead.

Baden Moore: Good morning, Scott and Jevan. Can I just get one follow-up question, just to clarify on the capital management, can you confirm... Essentially now this has completed the hundred mil capital returns still coming back to shareholders from here. And then the second question would be just when you think about the market and with the MSO and the refining subsidy in place, now I was just wondering whether there's any new regulatory requirements that you've had to sign on for as part of this deal and how your market fuels, or is there anything there that is worth flagging?

Jevan Bouzo: Hi Baden, it's Jevan here. I'll just cover the first point on the capital management and then I'll pass to Lachlan to talk a bit more around the package and the regulatory requirements. In the context of capital management, we obviously sold down the Waypoint REIT stake at the beginning of last year and committed to return that money to shareholders at the time. There's $100 million dollars of those proceeds remaining with the company, and earlier this year and late last year we had said that we would not proceed with returning those funds until we got some certainty around the refining outlook. But at the time we did state that we remained committed to returning those funds to shareholders in due course. And so I think it's fair to say that the company's commitment hasn't changed and as we progress through the course of this year, we'll continue to assess options to meet that commitment.

Scott Wyatt: Lach, did you want to cover some of the regulatory comments?

Lachlan Pfeiffer: Yep, sure. There's probably nothing further to what we put in the announcement. So obviously the key ones are the regulatory commitment to keep refining till June 2027 and then also to bring forward the fuel specifications for ultra low sulphur gasoline. So I think they're the key ones which are a part of this deal. The additional piece that we're working closely with the government on, it's actually been part of a long-term engagement, is further harmonisation with fuel specs to the Euro 6 vehicle emissions standards. That's a process and part of this package also committed to bringing forward one of the key reviews on that, which is the reveal of aromatics in gasoline. So we'll look to finish that off and do that review this year and then work with government about what can be done in terms of bringing gasoline and high octane gasoline and diesel fuel spec that harmonises to Euro 6 Ford. So there's nothing agreed on that as yet and there is quite a bit of work to do there, to how best to do, that fuels back to meet Australian environmental conditions and operating conditions, that's part of the discussion that we want to bring forward with the government as well.

Baden Moore: Thank you.

Operator: Thank you. Your next question comes from Scott Ryall, with Rimor Equity Research, please go ahead.

Scott Ryall: Hi there. Thank you very much, and congratulations from me as well. Just the intensity of the upgrades for the low-sulphur fuels, could you just confirm that can be done within your normal turnaround activity, please?

Scott Wyatt: Yeah. We would aim to do all the work to have it completed for tie-in when we do our next Cat Cracker Turnaround, which will be mid-2024. And so obviously, that means work needs to start immediately. We've actually... I mean, we have done quite a bit of work already on thinking about solutions and options, so it's not like we come from a cold start, but you would complete that work ahead of 2024, do the tie-ins, and then be on grade, before the end of 2024.

Scott Ryall: Okay, thank you. And then the second one, you've made a... on the front page of your release, you've talked about the transition to multiple sources of energy, as you participate in the long-term goal of energy transition, and that's all you've focused on there. Ampol, in their release this morning had literally paragraphs on the decision supporting a government partnership on energy transition and de-carbonization. Could you tell me why that's not a matter of emphasis for you guys? Or it doesn't seem to be overly important in terms of the announcement this morning.

Scott Wyatt: I mean, we announced our energy hub last year, which is sort of the foundation of our energy transition. And I mean probably about 12 months ago. And in those 12 months we've obviously progressed quite materially, the LNG import facility project, which is as I mentioned before, we're aiming get to a point where you can take FID on that next year, that's now become the leading project in Victoria. And we also announced earlier this year, a bunch of Hyzon motors to establish hydrogen applications in commercial road transport, so buses and trucks with customers in Geelong, and potentially a refuelling hub and maybe a hydro manufacturing down the track as well. So I think we are quite well advanced already on our transition story. We are and will continue to work closely with state and federal government on that. And it was good to see Minister Taylor in his announcement, this morning, talk about wanting to work with the refiners more closely on the energy transition over the next decade. And we would expect to be continually part of that, but it's really an ongoing dialogue that's already started by the state and federal governments because of the work we've already done.

Scott Ryall: Yep. Right. Perfect answer. Thank you. That's all I had.

Operator: Thank you. Once again, if you wish to ask a question, please press star one. Your next question is a follow-up from Michael Simotas with Jefferies. Please go ahead.

Michael Simotas: Thanks for taking another one, just a mechanical question. What's the period of measurement for the production payments. So does margin need to be below that level for a month, a quarter, et cetera.

Jevan Bouzo: Hi, Michael. It's Jevan here. I can take that one. Yeah. I mean, we're still working through the finer details. We've thought about the charts and their release and obviously, the way we report the refining margins to the markets. And we've typically focused on monthly reporting in the context of refining margins. At the same time, we often release results on a quarterly basis. And when you think about the interim production payment, that's in place at the moment, that's managed on a quarterly basis too. So, there's a little bit of work to do to finalise that, but you can assume that, that will be either monthly or quarterly. And so from a timing perspective, I think relatively manageable for the company.

Michael Simotas: Yeah. Okay. And I guess the reason I ask is, given the volatility in refining margins from a financial perspective, the shorter the measurement period the better.

Jevan Bouzo: Yeah, I think that's right. And I think the way to think about that too, is from a cashflow management perspective and making sure that the timing of cash flow's relative to operating costs out-flows aligns too. So there's a little bit to work through on that, but I think you can assume that we'll be in a reasonable position.

Michael Simotas: Thank you.

Operator: Thank you. There are no more further questions at this time. I'll hand back to Mr. Wyatt for closing remarks.

Scott Wyatt: Yeah. Thanks very much. Look and thanks again for joining. It's obviously an important day for our business, but particularly for the team and the business here at Geelong, I'm really pleased with the outcome it's been... Had really good engagements with government throughout the last 12 months. It's obviously, it's taken time because of the complexity in developing a package that actually lasts the distance over a long-term. And that was always going to be very critical to us to achieve that outcome. I think the package that's announced is a balanced package it sort of protects the country's energy security and the requirements of the nation, but also provides us with the level of long-term certainty that we need to retain operations and make the ongoing investment to improve our business and obviously contribute in furthering fuel standards, as well. So, I think it's a really good balanced outcome.

It's obviously reframes our business and certainly reframes our refining business by removing the downside risk and volatility in refining, whilst preserving the opportunity to enjoy recovery and refining margins. Which I do think is a real possibility in the future as oil demand recovers, and particularly with the amount of refining capacity that's been removed as a result of COVID and will continue to flow through over the next year or so. So, that's the opportunity that we were trying to preserve in this package along with maintaining a really important part of that business. And I believe this package achieves all of that, and then look forward to getting on that with the investments and operations that are ahead of us. But look, thanks again for joining, and have a good day.

Operator: That does conclude our conference for today. Thank you for participating. You may now disconnect.

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