

# REFINING, SUPPLY & TRADING

## Refining & Supply

The uncertainties that plagued the global economy in 2003 resulted in a lower than nameplate capacity refining throughput for the year. Demand and prices for crudes and products were strong in the first quarter on the back of the uncertainties generated by the preparations for war in Iraq. However, the swift resolution of the war resulted in weak and poor margins in the second quarter. This weakness was further exacerbated by the outbreak and spread of SARS in the region. Air travel in Asia Pacific slowed down dramatically and demand for products declined. The global economy, however, staged a surprising rebound in the second half of the year as governments and health authorities became more successful in coping with the SARS outbreak. Despite the challenging operating conditions, SPC's jointly owned refinery, Singapore Refining Company Pte Ltd ("SRC") was nonetheless able to achieve a crude throughput of 235,000 barrels per day in 2003, or more than 82 per cent of its nameplate capacity of 285,000 barrels per day.

Apart from high throughputs achieved in the primary distillation units, the utilisation rates were also high for all the conversion units. Higher value-added products from these conversion units were essential in boosting SPC's second half performance as demand for such products rebounded in the second half of the year. SPC was able to capitalise on the sophistication of the refinery and the customer network built up over the years to record a better performance in the second half of the year.

## Aviation Sales

The global aviation industry suffered two major setbacks in 2003. In the midst of struggling to balance air travel capacity against the much reduced air travel demand following the 9/11 events, the industry had to cope with the Iraqi war and then the SARS outbreak. Industry analysts have estimated the loss to the aviation industry over the past two years to be approximately US\$32 billion and the shedding of 400,000 jobs. Asian airlines were hit hardest by the SARS outbreak and had to resort to special promotional travel packages to

boost air travellers' confidence. Passenger air traffic in Asia Pacific started to pick up strongly in October but yield was low due to heavily discounted airfares. New security measures and punitive insurance premiums are expected to continue to plague the aviation industry.

In aviation sales, SPC achieved a market share of about 19.4 per cent or 13,010 bpd (barrels per day) of jet fuel sales at Singapore Changi Airport. The total airport throughput for 2003 of approximately 67,140 bpd was about eight per cent below the pre-SARS level. Competition was stiff and aviation sales margin was squeezed due to the decline in volumes by as much as 30 per cent during the SARS outbreak. SPC continues to service a list of 27 premium customers in this sector.

At Taipei's Chiang Kai Shek International Airport, SPC supplied approximately 2,110 bpd of jet fuel to its airline customers. Total airport volume dropped by about 40 per cent during the SARS crisis as airlines including United Airlines and ANA suspended flights to Taipei. SPC has six premium customers in this location.

In Hong Kong, SPC achieved a market share of 3.7 per cent or 2,570 bpd in Hong Kong International Airport. Hong Kong was one of the epicenters of the SARS outbreak, non-essential air travel to this hub came almost to a standstill at the peak of the SARS scare. Total airport volume plunged by about 50 per cent during that period.

In May 2003, SPC successfully secured approval from Bangkok Aviation Fuel Services PLC ("BAFS") to operate as an aviation fuel supplier at Bangkok International Airport. Singapore Petroleum (Thailand) Company Limited ("SP Thailand") was incorporated to oversee SPC's aviation supply activities, as well as the Company's marketing, supply and distribution and trading of petroleum products in Thailand. SP Thailand has successfully obtained an oil trader license in October 2003 and in November 2003, SPC commenced its into plane supply to airlines at Bangkok International Airport with its inaugural delivery to British Airways.

Although the aviation sales volume and margin were adversely affected by various events in 2003, SPC's aviation sales was able to contribute positively to the sterling performance achieved by the Group through proactive management. Air traffic in the region has regained momentum in the last two quarters and surpassed the pre-SARS level. The budget air travel market will expand with the introduction of low cost airlines in the region. SPC's aviation sales look forward to fostering new alliances in the future.

### Distillates

A key segment of SPC's downstream activities is the sale and trading of distillate products. Distillate products represent the lighter end of the refining process and include chemical naphtha, motor gasoline, catalytic spirit, kerosene (also known as jet fuel) and gas oil. Besides the availability of these products from SRC, the Distillate unit sourced products from other refineries and traders. Demand for distillate products were depressed during the first half of 2003 due to the Iraqi war and SARS outbreak. However, the economic rebound, together with pent-up demand post-SARS and consolidation of refiners in the region combined to fuel a strong petroleum product demand surge in Asia, particularly in China, Philippines and Australia.

Against this backdrop, the Distillate unit traded and competed aggressively to capture its share of the market. In 2003, the Distillate unit achieved a turnover volume of 15.5 million barrels which was 9.1 per cent higher than the previous year. Margins achieved were also above the targets set for the unit. The unit's good performance was attributed to close monitoring of the market and prudent management of inventories.

Product demand in the region is expected to be strong with the global economic recovery in 2004. Lower effective refining capacity due to closures and an ageing profile, the anticipated surge in air traffic and the strong growth in China will continue to provide fundamental support to the performance of SPC's Distillate unit. This unit will continue to play a key role in SPC's downstream activities and profitability in 2004.



The residue catalytic cracker complex at SRC

## Residue

The Residue unit continues to strengthen its reputation as a reliable supplier of a wide range of quality fuel oil products. These products of different viscosities are essential for the marine transportation sector as well as for power generation. In 2003, the unit has raised its trading profile with increased volume and varied activities.

In early 2003, preparations and stockpiling of products for the Iraqi war led to a supply-demand disequilibrium that resulted in sharp spikes in product prices. This challenge was but one of several that the Residue unit had to grapple with in 2003. Other challenging dynamics include rigorous environmental legislation and an intensive focus on product safety, quality and improved industry practices. The Residue unit derives competitive advantages from its world-class processing facilities and reliable services. It met its supply commitments fully and contributed positively to the Group's performance.

Marine Sales is an important activity for the unit. The ready product availability and quality ship bunkering services provided by the unit continued to position SPC as a choice bunkering partner to many vessels that call at Singapore's port. Despite stiff competition, Singapore's pre-eminent position as a major bunkering hub was not eroded. To augment and further promote Singapore as a bunkering port of call for vessels plying the region, the authorities opened two new ship re-fuelling anchorages in the west of the port known as Sudong Bunkering Anchorage A and B. These anchorages complement the existing seven anchorages. Furthermore, to encourage a greater volume of bunkering activities in Singapore, the authorities have also introduced port dues discount.

In 2003, Singapore maintained its status as the world's busiest bunkering port. The Republic recorded a total bunker tonnage of 20.8 million tonnes, a 3.5 per cent increase over the volume achieved for 2002. It is estimated that the bunkering industry is worth some \$6 billion a year. SPC has maintained its market share of approximately 13 per cent of the total bunker tonnage of Singapore marine fuel.

In June 2003, the Maritime and Port Authority of Singapore implemented an accreditation scheme for bunker suppliers. This is another significant milestone in the process of ensuring good practices in bunkering activities in Singapore. Since deregulation of ship bunkering in the mid 1980s, there had been regular crackdowns by the authorities on suppliers engaging in less than desirable trade practices. Measures implemented by the authorities included accreditation, prosecutions and license cancellations to maintain Singapore's reputation in the bunker trade. SPC has always maintained the highest standards in marine sales activities and is recognised for its quality service and fast turnarounds. SPC's Residue unit intends to leverage on these developments in the industry to expand while maintaining SPC's reputation as a reliable supplier of quality bunker in Singapore.

The Residue unit is also actively engaged in bunker trading in other ports including Hong Kong, Malaysia and Taiwan. These activities are carried out by Marine Sales. Another important activity of the Residue unit is fuel oil trading.

The Chartering/Marine Operations unit is responsible for providing logistics planning and support to SPC's business units. This unit plays a crucial role in ensuring smooth operations and the efficient and effective control of operational cost.

The SPC Group continues to maintain its competitive edge in the bunkering business with its 220,000 cubic metre storage terminal at Pulau Sebarok. This terminal offers first class terminalling facilities, storage and full laboratory testing capability.

Going forward, the Residue unit will focus on maintaining and strengthening SPC's reputation as a reliable bunker supplier and fuel oil trader. The Group will continue to place emphasis on effective and efficient trading and operational conduct, and conform with best practices in the industry to deliver on the Group's commitment to service excellence and product quality.



SPC owns a 220,000 cubic metre oil storage terminal in Singapore

### Risk Management & Derivatives

The Risk Management & Derivatives unit (“RMD”) is responsible for the management of the Company’s crude inventory & refining margins price risk and the trading of oil derivatives.

In assessing and managing market risk, the Group adopts the Value-At-Risk (“VAR”) framework which measures the worst expected loss over a given time interval under normal market conditions at a given confidence interval. In 2003, RMD hedged and traded approximately a notional volume of 10 million barrels of oil through both over-the-counter and exchange-traded oil derivatives.

Crude prices were firm but volatile in 2003. Instability in the oil producing nations of Iraq, Venezuela & Nigeria and the relatively low crude inventory stocks in both the US and OECD

(Organisation for Economic Co-operation and Development) boosted oil prices to their highest yearly average in more than 20 years in 2003. The US benchmark crude oil prices on the New York Mercantile Exchange futures market averaged US\$30.84 per barrel in 2003, an increase of 19 per cent from the average in 2002.

Volatility will continue to be a key feature in 2004 with uncertainties over production levels in post war Iraq, political instability in Nigeria & Venezuela, and OPEC’s resolve in maintaining its price band mechanism of US\$22-28 per barrel. Competition from Russia and West Africa and a weakening US dollar will further test OPEC’s resolve.

For 2004, RMD will continue to proactively fine tune its hedging and trading strategies to better manage the Group’s VAR and to take advantage of market opportunities that may arise.