

Terms of Reference – Fuel Market Financial Performance Study

Context

1. The Ministry of Business, Innovation and Employment (MBIE) monitors the performance of markets for the supply of energy in New Zealand, including the supply of petrol and diesel. The markets for petrol and diesel are unregulated and have historically been considered broadly competitive. However, MBIE has observed a trend of rising importer price margins since 2008, and proposes to commission a study to better understand the significance of that trend. The study may extend to a consideration of the effectiveness of competition and measures to improve competition in the relevant markets.

Proposed Study

2. The proposed study into the financial performance of the New Zealand fuel industry will be an important input in the Government's efforts to build an accurate picture of the overall performance of the fuel markets in New Zealand, and is likely to significantly influence any further work carried out by the Government. Consultants selected to undertake the study will be asked to address the questions set out below, using information currently available in the public domain and using additional information that may be provided by relevant firms. MBIE will seek to facilitate access to additional information (such as performance measures derived on the basis of replacement cost of sales operating profit) but cannot guarantee if, or how promptly, it will be made available.

Part 1: Financial performance and cost of capital benchmarks

Subpart 1(a): Return on average capital employed

3. On both historical cost and replacement cost bases (HCOP and RCOP), what is the return on average capital employed (ROACE) of the major businesses (Z Energy, BP, Mobil and Gull), individually and in aggregate, for both fuels and non-fuels, in each year since 2011? Report also on Chevron NZ for the period 2011 to 2015. What factors might explain any trends in ROACEs and what future trends might be expected and why? (Note that we expect the major businesses to provide financial information on a financial year basis, which is the calendar year for all but one.)
4. Provide ROACEs at the level of each integrated business and broken down by market and product segments, to the extent possible given the available information. In particular, please estimate ROACEs on an RCOP basis, for each of the major fuel suppliers for each year since 2011, by:
 - a. Midstream, in aggregate and broken down as applicable by:
 - i. Refining NZ
 - ii. Primary distribution of refined products (Refining NZ pipelines and terminals – distribution to Auckland, coastal shipping – COLL, distribution by truck)
 - iii. Terminal storage and associated pipeline facilities
 - b. Commercial supply of refined products, in aggregate and broken down as applicable into the following market segments:
 - i. Aviation
 - ii. Marine

- iii. Bitumen
 - iv. Card
 - v. Bulk
 - vi. Distributor, and
 - vii. Other
- c. Retail supply of refined products (primarily petrol and diesel). ROACE estimates for retail should split out returns from fuels versus non-fuels, and where possible be broken down by region.
5. ROACE estimates by market and product segment, and by region, should be prepared utilising a generally accepted cost allocation model that allocates costs appropriately, and be presented both with and without any asset revaluations that have occurred since 2010.
 6. ROACE estimates may include the cumulative impact of differences in historic cost earnings and replacement cost earnings when calculating net assets on a replacement cost basis. The base year for these adjustments would be 2011.
 7. Identify any other financial performance metrics relevant to assessing the competitive performance of the sector? Where relevant, these other financial performance metrics should be applied to each of the major fuel suppliers.
 8. Taking into account the nature of the business activities, economies of scale, and any other relevant matters, how does the ROACE (and any other relevant financial performance indicator) of the fuel suppliers in New Zealand compare with those of:
 - a. comparable fuel suppliers in other countries, and
 - b. firms engaged in comparable wholesale or retail activities in other sectors in New Zealand or elsewhere (e.g. energy utilities)?

Cost of capital benchmark range

9. Given the nature of the business activities, market risks, scale economies, cost of debt, and any other relevant factors, what is an appropriate benchmark weighted average cost of capital (WACC range) for a business engaged in wholesale and retail supply of fuel in New Zealand?
10. What benchmark WACCs are applied in the regulation of comparable fuel supply businesses in other countries?
11. How do the ROACEs of fuel suppliers in New Zealand compare with the benchmark WACC range (informed by responses to the questions above)? Are the ROACEs reasonable, given the nature of the fuel wholesaling and retailing?

Subpart 1(b): Margin analysis

Gross and net margins (accounting margins)

12. What are the annual gross and net margins of each of the major businesses (Z Energy, BP, Mobil and Gull), individually and in aggregate, by business channel and product type, and by region. What trends are apparent since 2011? What factors might explain any trends and what future trends might be expected and why?
13. Relevant product types and business channels are set out in the table below.

Product type	Business channel
Petrol	Retail
Diesel	Commercial – card
Jet fuel	Commercial –bulk
Fuel oil	Distributor
Bitumen	Aviation
	Marine
	Other

14. Gross margin means revenue less taxes and cost of goods sold (COGS) on a replacement cost basis (and with COGS reported on a consistent basis).
15. Net margin means gross margin less other operating costs. Common operating costs may be allocated between business channels, product types and regions using appropriate allocators such as staff numbers or volume.

Subpart 1(c): Other market performance measures

16. What inferences can be drawn from analyses of prices and volumes in discrete products and markets? What time series analyses of fuel prices and volumes at the level of retail outlets or regions could be used to inform an understanding of price and margin movements in those products and locational markets over time?
17. What characteristics of the market explain differences in fuel prices between regions? What financial or non-financial indicators best measure the effectiveness of competition at a regional level?

Part 2: Conclusions and observations

18. What conclusions can be drawn from the financial performance and cost of capital benchmarks, margin analysis or other market measures? What conclusions can be drawn from the financial performance and cost of capital benchmarks? In particular:
 - a. Are retail consumers in New Zealand paying reasonable prices for petrol and diesel and why? At what level might prices be considered unreasonable?
 - b. What conclusions can be drawn about retail fuel price differences at a regional level?
19. To the extent that returns in any individual market segment are considered to be unreasonably high, what are the market features that limit the effectiveness of competition in this market segment? What regulatory or non-regulatory barriers may prevent the entry and/or expansion of new competitors in national or regional fuel markets?
20. For any material barrier to market entry and expansion identified, what specific measures could be considered to reduce it and what are the estimated costs and benefits of any measures identified above?
21. What further work, if any, should be carried out to build an accurate picture of the performance of fuel markets in New Zealand?
22. An outline of the approach undertaken, summary findings and all information in the conclusions and observations section should be presented in an aggregate form that can be publicly disclosed.