

**Caltex presentation**  
**to**  
**Senate Economics Legislation Committee**  
**Inquiry into the Price of Petrol in Australia**

**13 October 2006**

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## **Introduction**

Mr Chairman, thank you for the opportunity to meet with the Committee today and to present Caltex's position on the Price of Petrol in Australia. I would like to briefly explain where Caltex sits in the Australian oil refining and marketing industry, how our position is significantly different from our global major competitors and then run through what we think are the more important comments we have made in our submission.

Because the comments I would like to make have been extracted from the Caltex submission to this Inquiry, the chart numbers in the document we have handed out this morning refer to the charts in the submission. I understand that the Committee members may wish to ask questions on our material.

## **Background - Caltex structure and operations**

Caltex Australia Limited is Australia's leading refiner and marketer of petroleum products, which are sold under the Caltex, Caltex Woolworths and Ampol brands. Caltex is the only major refiner and marketer listed on the Australian Stock Exchange. Chevron Corporation of the US is a 50% shareholder but Caltex is not a subsidiary and all decisions are made by Caltex's Australian board and management.

Caltex is engaged in refining and marketing only and has no exploration or production interests, nor any overseas refining or marketing operations. We have to buy all our crude oil on the world market at world prices regardless of whether it comes from Asia, the Middle East or Australia.

Caltex has two refineries, in Sydney (Kurnell) and Brisbane (Lytton) and as at 31 December 2005 owned or leased 546 service stations within a network of about 1900 branded service stations. Caltex has about 3000 employees.

Caltex's average profit (on a replacement cost of production basis ie. excluding the effect of crude oil price movements on inventory) across all petroleum products, including petrol, in 2005 was only 2.2 cents per litre.

The profit for first half 2006 equates to 1.8 cents per litre on average for all petroleum products sold. (For first half 2005, the figure was 1.7 cents per litre.)

Unlike our major competitors, Caltex Australia's focus is entirely on refining and marketing in Australia. The global majors have their primary focus on oil and gas exploration and production, their capital allocation is focused on exploration and production. I'm very pleased to have the opportunity to lead a company where our sole focus and capital allocation is on refining and marketing – ensuring a secure supply of transport fuels and lubricants for the country.

Our vision is to be the Australian oil refining and marketing company most admired for its people, partnership and performance.

### Term of reference (a)

#### The relationship between the landed price of crude oil, refining costs, the wholesale price and the retail price of petrol.

The term of reference implies the price of petrol in Australia is related to the cost of manufacture ie. the price of crude oil plus the margin applied to manufacture the raw materials into finished products. However, this is not the case – the market determines petrol prices, not costs. Refiners are price takers NOT price makers.

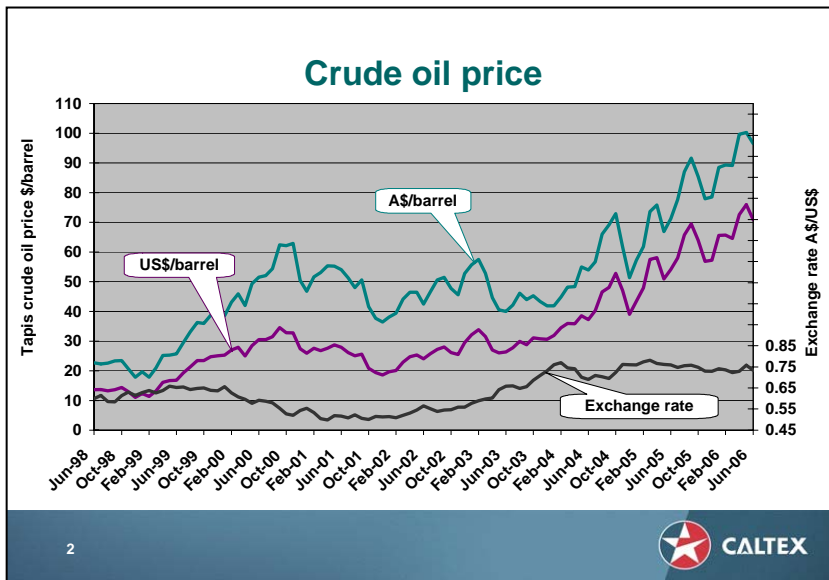
The international market for petrol is the dominant influence over the level of petrol prices in Australia. Local factors including wholesale and retail margins and freight, as well as discount cycles experienced in many major cities, affect prices but to a lesser extent. However price relativities and price variability are often very visible to consumers day to day and may attract considerable media attention.

Import parity pricing for crude oil and petroleum products has been the basis of petroleum product pricing policy since 1988. This coincided with many other economic reforms started under the Labor Government in the 1980s and continued by the Coalition Government. Since wholesale price deregulation in 1998, import parity pricing for petroleum products has continued to form the basis for pricing in the petroleum products market.

Importantly, this pricing basis – together with Australia's low petroleum tax regime – has consistently led to the country having some of the cheapest petrol prices in the OECD with only the lower tax countries of the US, Canada and Mexico being less expensive.

Caltex supports the continuation of an unregulated petroleum products market in the belief that the current arrangements provide the best environment to encourage the large on-going requirements for capital investment in the industry and the maintenance a secure supply of transport fuel for Australia.

**Chart 2**



**The landed price of crude oil does not determine the retail price of petrol in Australia.**

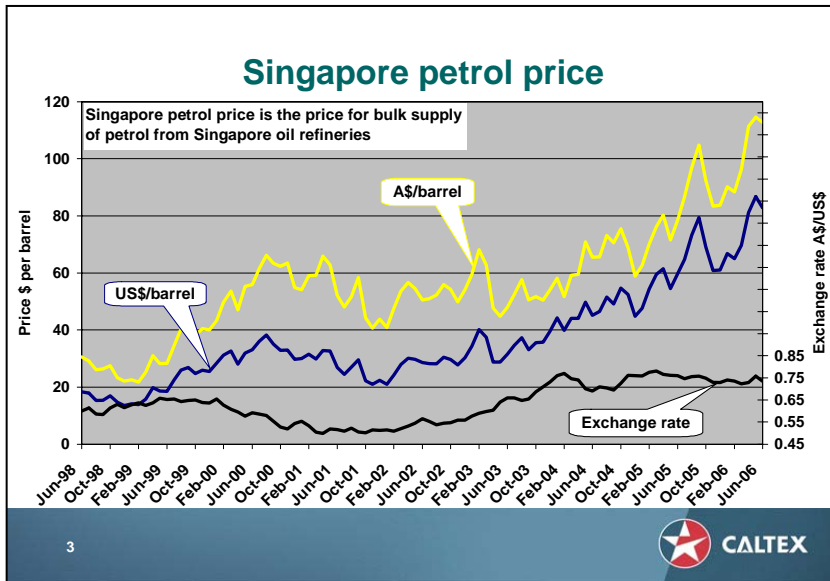
However, the price of petrol is related indirectly to the price of crude oil as a result of its underlying effect on Singapore petrol prices.

Chart 2 shows the price of Tapis crude oil since 1998 in US\$ and A\$ per barrel.

90% of the increase in petrol prices since first half 2005 has been due to

higher crude oil prices and only 10% to higher refiner margins.

Chart 3



The price of petrol in Singapore forms the basis of the price of petrol in Australia.

Chart 3 shows Singapore petrol price (MOPS95) over the same period as Chart 2. MOPS95 is industry jargon for the market price of generic quality 95 octane petrol quoted by Platts.

The pattern of prices over time is similar to crude oil, with prices typically in the A\$50 to 60 per barrel range from 2000 to early 2004. A spike in

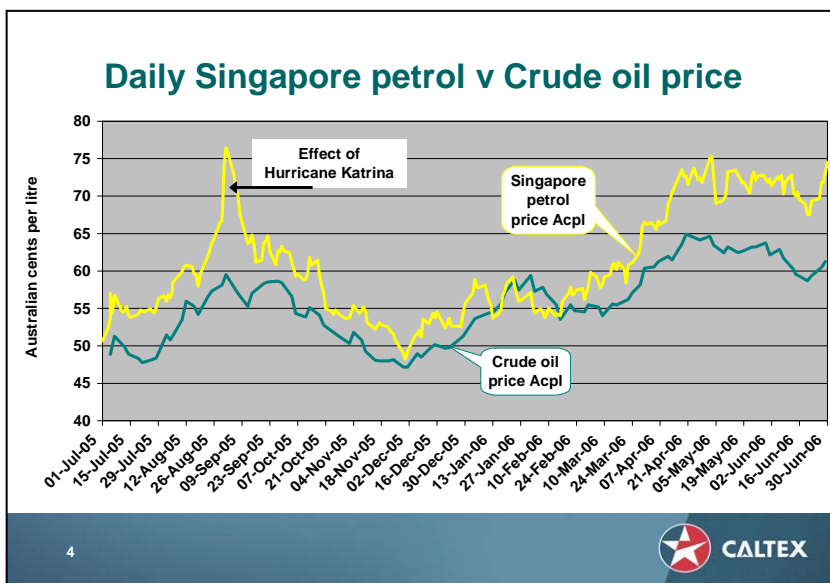
March/April 2003 marks the Gulf War and another spike in September 2005 marks Hurricanes Katrina and Rita. From mid 2004, prices rose sharply due to underlying crude oil prices.

As discussed earlier, prices for petrol from Australian refineries are not based on the actual cost of imported petrol or the crude oil that is refined into petrol. Instead, the ex-refinery price of petrol is based on the Singapore market price for petrol, adjusted for Australian fuel standards and freight to Australia; the price is not regulated but instead determined by market forces.

The reason Australian petrol prices follow Singapore market prices is that Australian refineries must compete against petrol imports (overall 17 per cent of Australia's petrol was imported in 2005) and Singapore is a major source of petrol for importers.

The crude oil markets and the petroleum product markets are completely separate, distinct markets. Traders in these markets influence the prices based on supply and demand, real and perceived shortages and geopolitical instability.

Chart 4

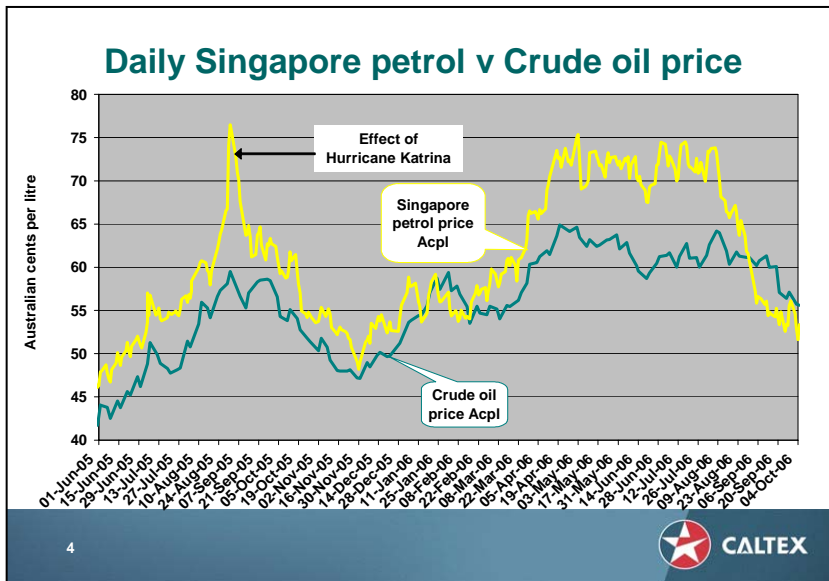


The prices of Singapore petrol and crude oil do not necessarily rise or fall at the same time or to the same degree.

Chart 4 shows Singapore petrol price (MOPS95) v Tapis crude oil price, both in Australian cents per litre (Acpl). The petrol price spike caused by Hurricane Katrina in the US is clear but so is the rapid decline almost immediately after the peak. Within two weeks, the price increase completely dissipated, with refiner margins lower

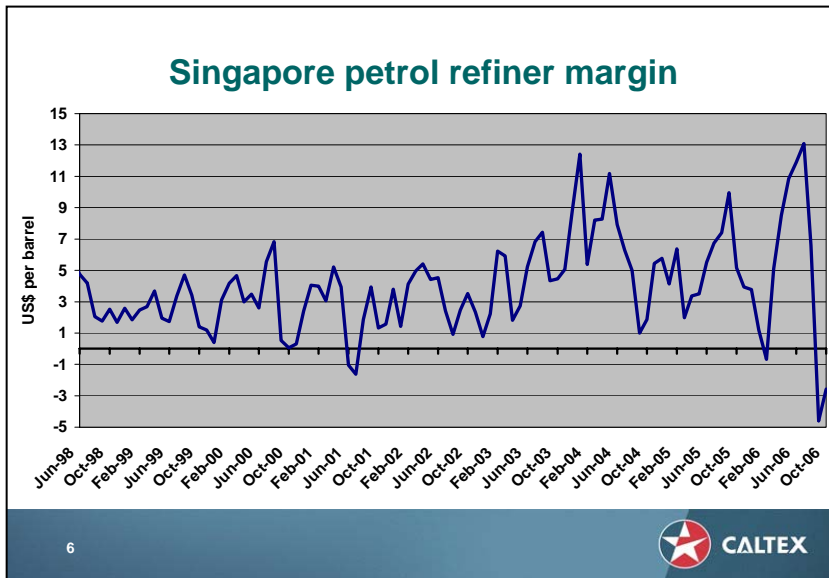
than before the effects of the hurricane.

Chart 4A



In February 2006, refiner margins were negative i.e. petrol prices ex-refinery were lower than the cost of crude oil used to make it. This also occurred in mid-2001. It has occurred again last month as the following chart illustrates. And this week the price of petrol is about the same as the price of crude oil.

Chart 6A



**The Singapore refiner price is a market outcome, and the resultant margin is calculated as the difference between the selling price of petrol ex-refinery and the cost of Tapis crude oil, not determined by refiners.**

Chart 6A, which has been updated to this week, shows that the average Singapore refiner margin from 1998 to 2002 was about US\$3 per barrel. Since 2003, the average has been about US\$5 per barrel, which is about

US\$2 per barrel or 2 Acpl greater than the earlier period.

Because we are price takers not price makers, the price of petrol is a market outcome – it is not 'set' by refiners on a 'cost-plus' basis. This is demonstrated by the negative margin for petrol in February 2006 – you could buy petrol cheaper than Tapis crude oil. And the same circumstances have occurred over the past month. This resulted from the market setting the Singapore petrol price. If it was set from a cost build-up, the refiner margin would never be negative.

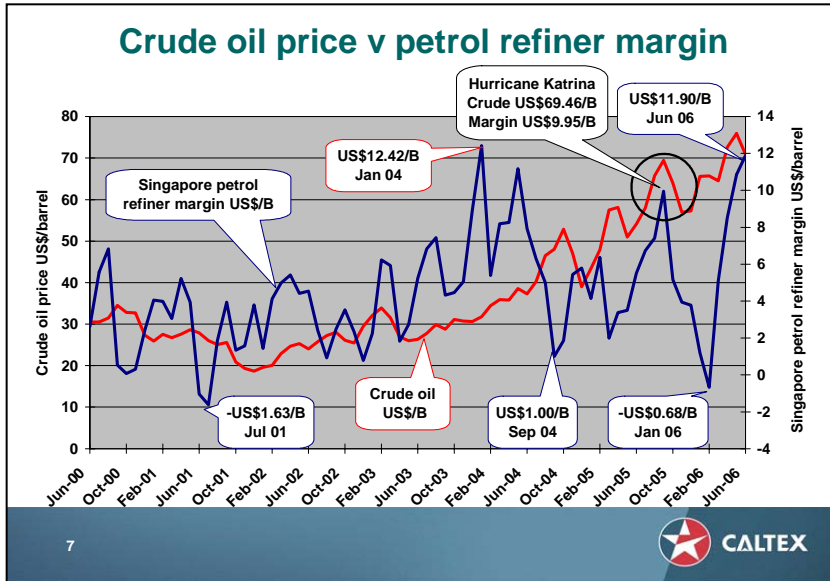
The increase in February occurred because from mid-2003, Chinese demand for petrol from fast-growing new car sales pushed up refiner growth until mid-2004 when demand controls applied by the Chinese Government eased petrol demand growth and as a result Singapore petrol prices. From 2Q2005, northern summer demand (driving season) pushed up petrol refiner margins with Hurricane Katrina striking on 30 August. Margins quickly returned to more normal levels.

Margins fell in early 2006 due to weak demand and increases in underlying crude oil prices, then increased sharply as demand recovered in the run-up to the northern summer (when demand increases) and many refineries in the region undertook planned maintenance.

Then over the last month the petrol refiner margin has been negative as demand on refineries in Asia for product has severely dropped away. This may be because oil companies in the US built up big inventories of gasoline in anticipation of supply interruptions caused by the sort of Gulf of Mexico hurricanes that occurred in 2005 and now have to sell those stocks in a slower market before needing to import from Asia again.

In summary, while petrol refiner margins to mid 2006 were higher than on average early this decade, the increase is not significant in explaining the large increase in pump prices – that is mostly due to higher crude oil prices as discussed earlier.

Chart 7



**The Singapore petrol refiner margin and crude oil price do not rise or fall at the same time.**

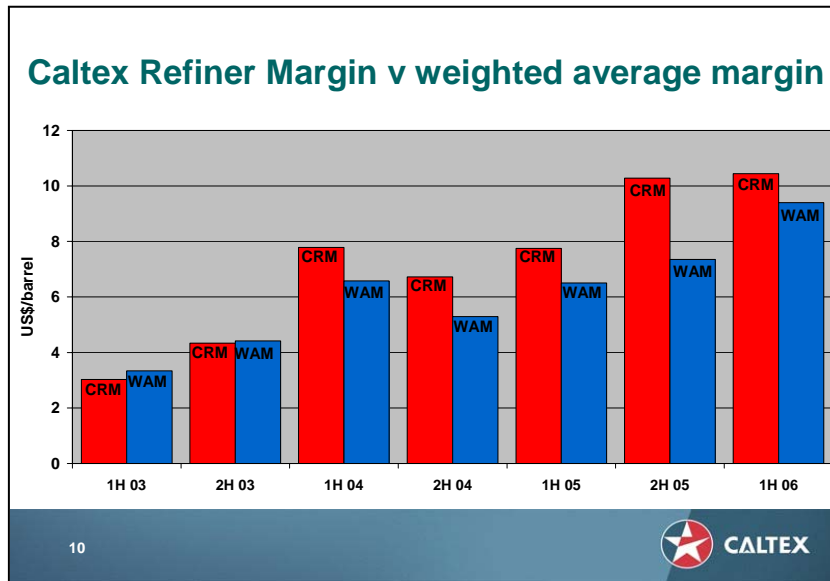
It has sometimes been asserted by sources outside the oil industry that higher petrol refiner margins are correlated with higher crude oil prices.

Chart 7 shows that while crude oil prices have trended up since 2002, petrol refiner margins are constantly changing, sharply rising or falling.

Any correlation of the two is limited as regional petrol prices relative to crude are influenced primarily by regional supply and demand fundamentals for petrol while crude tends to be driven by more global supply issues overlaid by geopolitical sentiments.

It would be more helpful for the public if the media quoted the Platts Singapore MOPS95 petrol price on the news each night rather than the Tapis or West Texas Intermediate crude oil prices.

Chart 10



**The Caltex Refiner Margin has increased more than the Singapore weighted average margin due to tougher Australian petrol standards.**

While the Singapore weighted average margin (WAM) – a general indicator of regional refiner margins – has increased due to tightening regional supply/demand, a more accurate calculation for Caltex takes into account factors unique to Caltex.

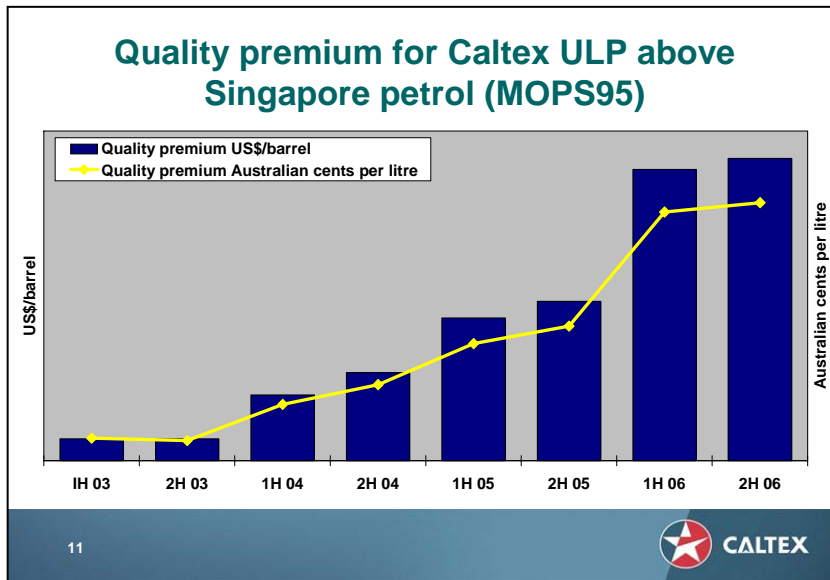
The weighted average Singapore refiner margin (WAM) is based on quoted Singapore margins achieved for the Caltex basket of products over the benchmark crude (Tapis).

The Caltex Refiner Margin (CRM) represents the difference between the cost of importing a standard Caltex basket of refined products to Eastern Australia and the cost of importing the crude oil required to make that product basket.

The CRM calculation  
 = average Singapore refiner margin (WAM)  
 + premium for Australian product quality  
 + crude oil price discount or premium  
 + product freight  
 - crude freight  
 - yield loss in refining.

The Caltex Refiner Margin (CRM) is published by Caltex every six months as part of its presentations to stock market analysts, which is available on the ASX and Caltex web sites.

**Chart 11**



**The quality premium for Australian petrol has increased with the introduction of tougher Australian fuel quality standards.**

Tougher national fuel quality standards mandated by the Australian Government to help reduce vehicle exhaust pollution have meant that petrol produced for the Australian market is now required to contain a maximum of 1% benzene, down from the previous (unregulated) range of 2

to 3%. Since 2003, petrol standards have also been mandated for the content of MTBE, olefins and aromatics, and final boiling point, which are tougher than former voluntary industry standards. These new standards will significantly improve public health and, in the case of MTBE, safeguard water quality

Caltex has invested about \$500 million in upgrading its Kurnell and Lytton refineries to enable them to produce higher quality petrol and diesel.

Tougher petrol standards have increased Caltex's wholesale price of petrol by about 2.5 cpl since 2003.

This is similar to the 2.5 cpl increase in Victorian terminal gate prices (TGPs) for petrol relative to MOPS95 found in a May 2006 report by Consumer Affairs Victoria, which failed to take account of the increase in petrol quality since 2003. This means that contrary to the implication that Victorian TGPs have increased by an amount that is unjustified, the increase has in fact been the result of regulated higher petrol quality.

### **Wholesale prices are calculated using an import parity formula.**

The bulk supply price for refined products into terminals is known in oil industry jargon as the “buy-sell price” and is commercially negotiated every 6 months on a bilateral arms-length basis between each of the Australian refiners (and potentially other Australian bulk suppliers) either for sale or purchase. The price varies by location. The “sell” part of “buy-sell” is relevant to states where oil companies have refineries and sell to other bulk suppliers; the “buy” part is relevant where they have no refineries and must purchase from local refiners (or importers). Import prices are negotiated on a cargo by cargo basis. Buy-sell contracts are commercial arrangements and the ‘buy’ party can import product as an alternative. In Queensland, NSW and Victoria, there are two domestic refiners in each state as sellers, which generates competition in addition to imports.

We would be pleased to answer any questions you might have on the confidential sections of the Caltex submission described in the following:

**Table A1** (available in the confidential appendix) shows a buy-sell price calculation for petrol for a specific day in second half 2006, which is based on the applicable daily Singapore prices. The calculation is in accordance with the negotiated contract formula for 2H2006.

**Table A2** (available in the confidential appendix) shows the calculation of Caltex's wholesale price (“Caltex Reference Price” or CRP) for petrol, which is the basis for pricing to service stations and resellers. A discretionary after sale rebate off the CRP (“price support”) may be provided to franchisees to help them meet local price competition; wholesale prices to resellers and non-franchised retailers are generally discounted at time of purchase and do not attract price support.

**Table A3** (available in the confidential appendix) explains the CRP calculation in more detail.

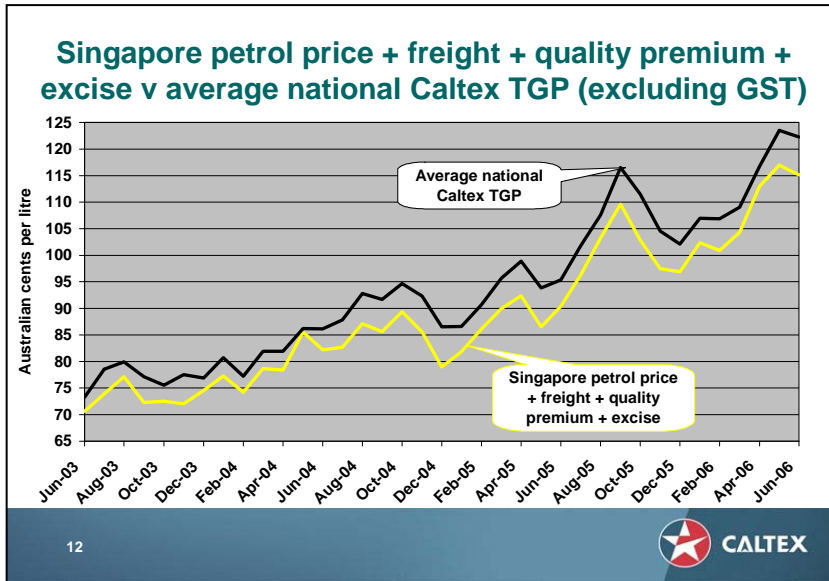
These tables show that pricing of petrol is not arbitrary or particularly complex, although necessarily confidential. Prices are related to an import parity price calculation and closely follow movements in international petrol prices through the linkage to Singapore prices.

A terminal gate price (TGP) is also posted at each Caltex terminal and available on the Caltex web site, [www.caltex.com.au](http://www.caltex.com.au). This is the spot price for a road tanker load (typically about 42,000 litres) of unbranded bulk petrol supply from the Caltex terminal for cash. The TGP calculation is similar to buy-sell except it uses a 7 day rolling average of Singapore prices and exchange rates, is adjusted only twice weekly (daily for Victoria), and includes a terminalling cost and competitive wholesale margin for the particular terminal location.

The proposed mandatory industry code of conduct (Oilcode) under the Trade Practices Act, which is part of the Government’s retail petroleum reform package, will require all wholesale suppliers to post TGPs at each wholesale facility and make supply available at these locations at the TGP. While most suppliers already post TGPs at terminals, Oilcode will ensure this is done comprehensively and consistently, so adding to price transparency. Caltex does not use TGP as a basis for term contracts. However, Oilcode once regulated will require wholesale suppliers offering term supply of declared petroleum products to customers to give those customers the option of TGP-based term contracts.



Chart 12



**Changes in terminal gate prices are closely related to changes in the import price.**

As shown by Chart 12 there is a close relationship between Caltex's terminal gate prices (TGP – shown here as the national average TGP) and import prices. The difference in price has remained fairly constant over time and changes in TGP are closely related to changes in import prices. This means that changes in TGP are a good proxies

for changes in international prices, which is useful for price transparency as TGP are more readily available to the public than international prices.

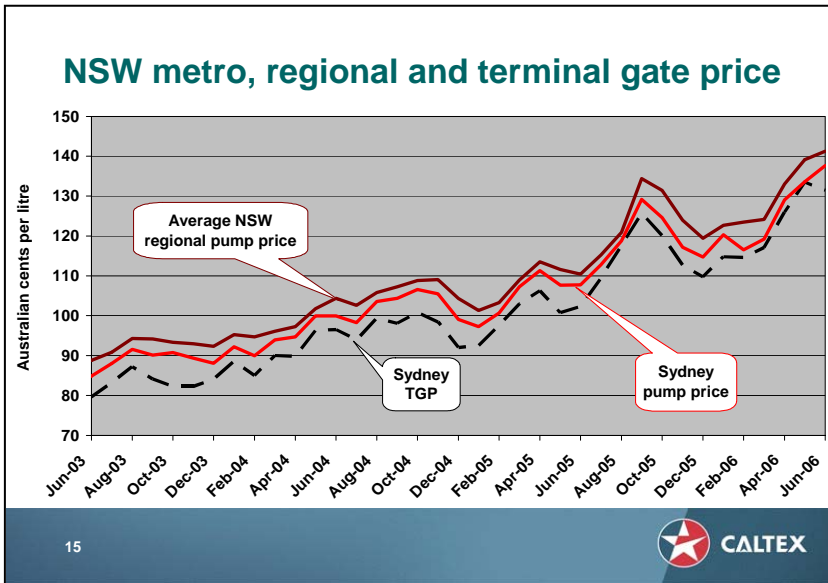
The import price shown in the chart includes Singapore petrol price (MOPS95) plus international freight plus a premium for Australian petrol quality. Excise has also been added to make the numerical comparison with TGP easier. GST is not included in either price. The gap between TGP and import price shown in this chart is due to insurance on sea freight, wharfage charges, terminal costs and a supplier's margin.

The gap between the two prices averaged 5.5cpl in 1H06, similar to the gaps of 6.0 cpl in Calendar 2005 and 4.5 cpl in Calendar 2004.

**Term of reference (b)**

**Regional differences in the retail price of petrol**

**Chart 15**



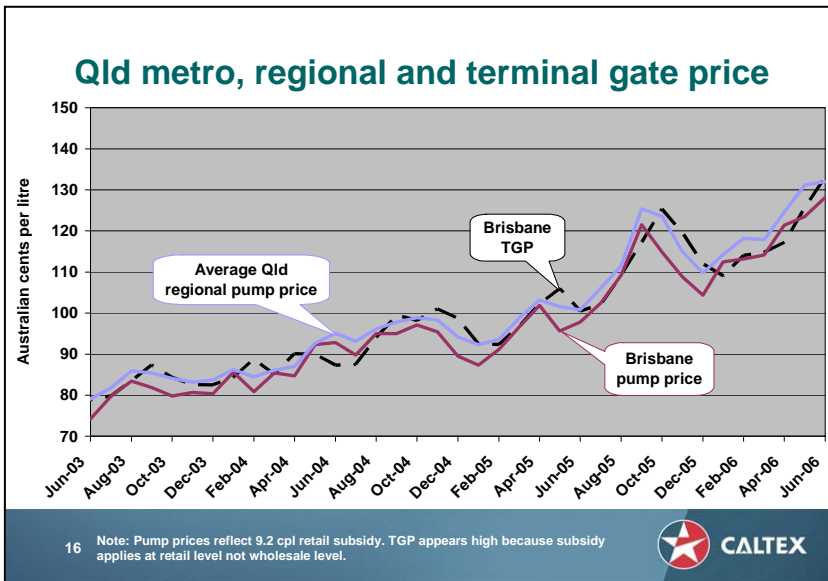
Metropolitan and regional pump prices closely follow terminal gate prices which closely follow changes in international prices.

Caltex's terminal gate prices (TGP), which are published daily, are calculated based on the cost of imports to Australia, terminal costs and a wholesale marketing margin plus excise/subsidies and GST.

TGPs are spot prices for bulk supply of fuel ex-terminal and are therefore a reasonable proxy for wholesale prices. Actual wholesale prices typically include charges for brand, credit, and site and equipment rental but also may be discounted according to competitive conditions in various markets and customer size.

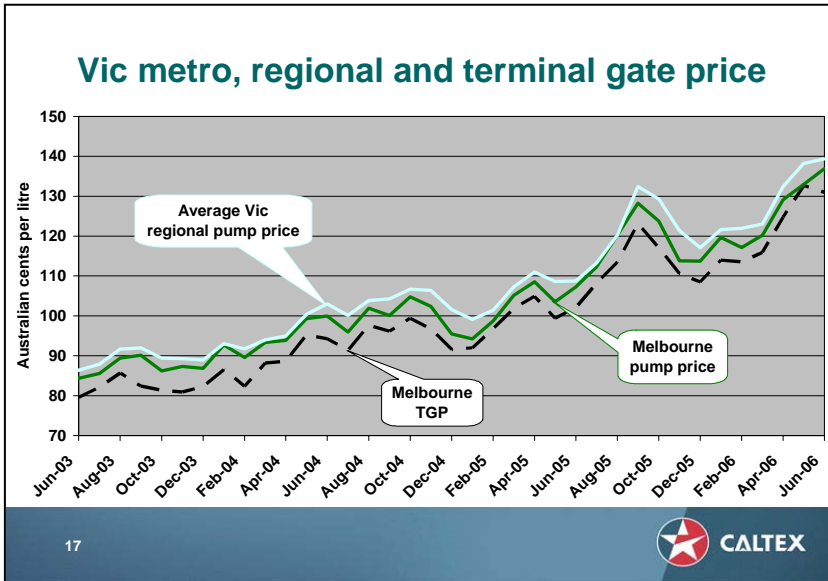
For each state, monthly average regional and metropolitan prices (AIP data prepared by Orima Research) are shown, together with capital city Caltex TGPs. The differences between regional and metro prices are due to wholesale and retail margins and freight.

**Chart 16**



Note: Pump prices reflect 9.2 cpl retail subsidy. TGP appears high because subsidy applies at retail level not wholesale level.

Chart 17



The data for the charts is as published by the Australian Institute of Petroleum (AIP) on its web site. (Note the Queensland TGP does not include the state retail subsidy of 9.2 cpl including GST, so pump prices appear low relative to TGP.)

The charts, being state averages, do not show the variation between individual country towns, which are often the subject of media and political interest. In almost all cases, these differences are the result of local competitive factors, including site volumes and site density, the presence of discounters including supermarkets and the impact of new entrants seeking to establish volume.

Retail margins (pump price less wholesale price) are typically higher in the country compared with major capital cities, mainly due to lower fuel volumes and shop sales over which to spread service station operating costs.

Distribution costs (included in the wholesale gross margin) may be significant for country areas where fuel must be stored in depots and double-handled, rather than being delivered directly from coastal terminals.

Freight is typically 1.5 to 3 cpl greater for country than city delivery.

Chart 18

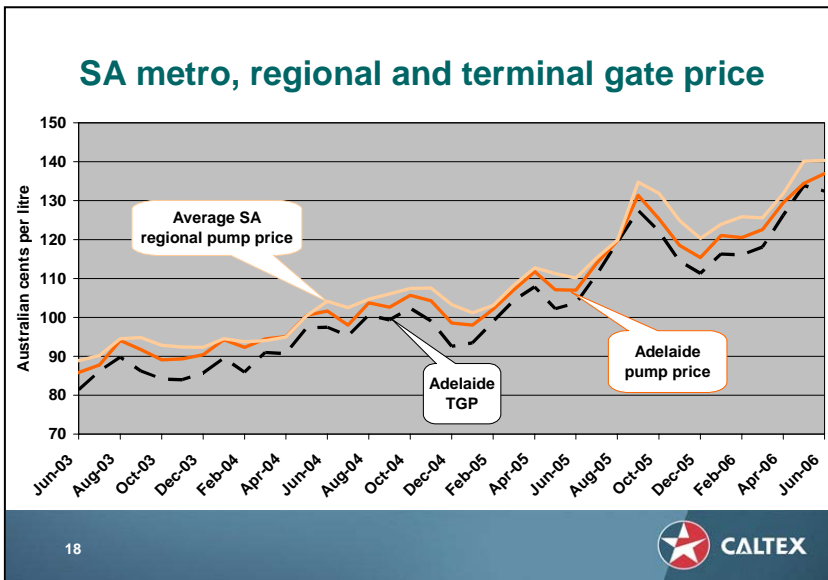


Chart 19

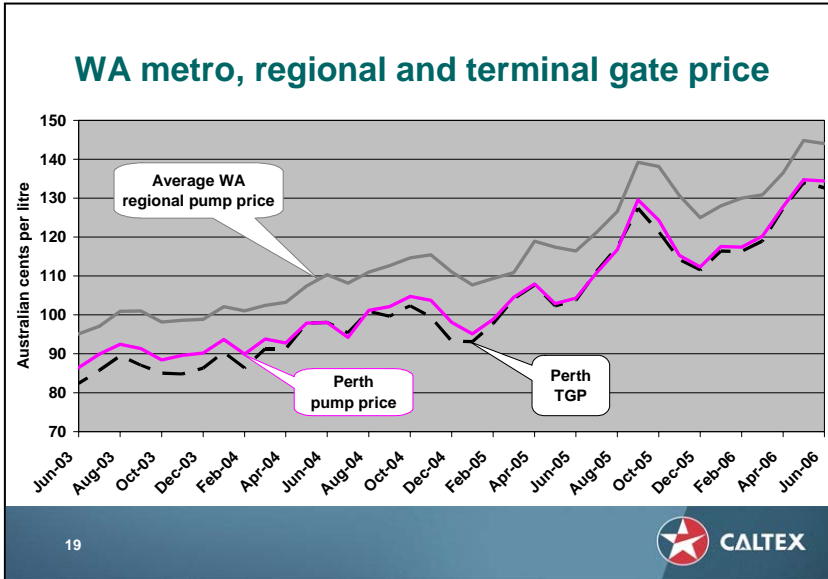


Chart 20

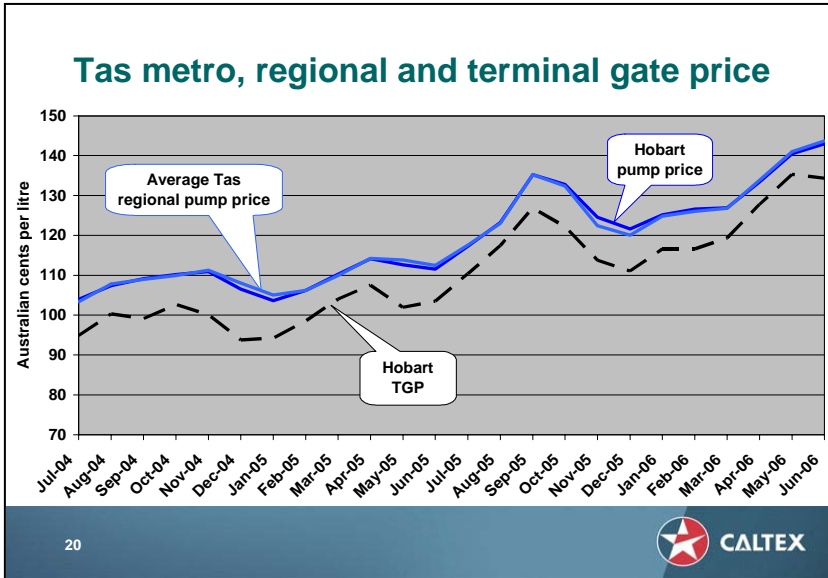


Chart 21

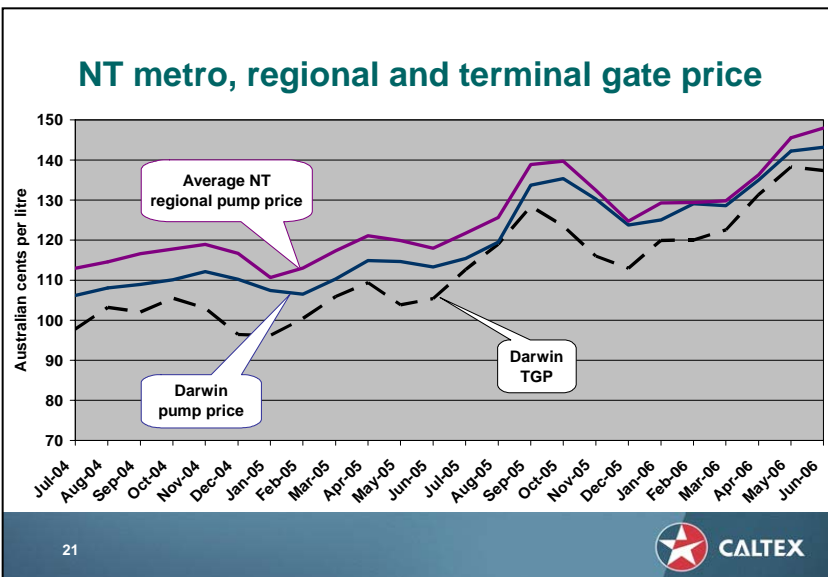
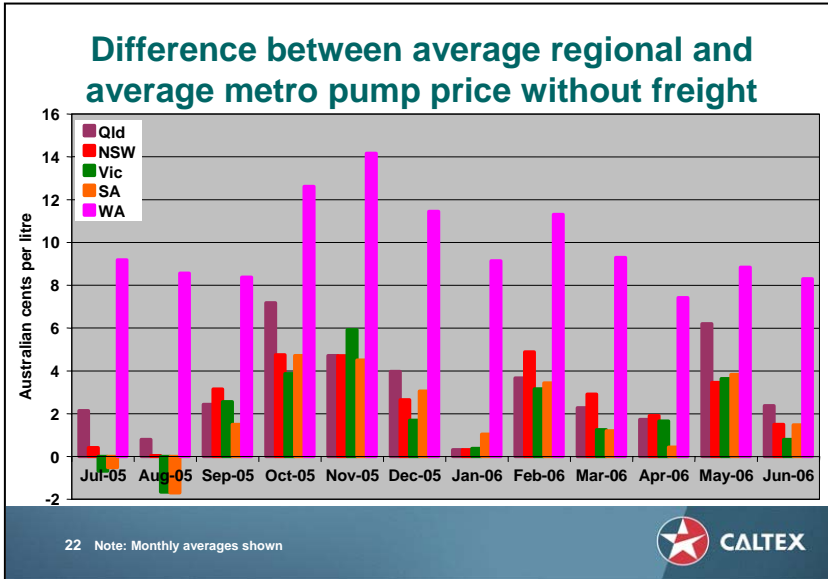


Chart 22



There is only a small difference on average between the average prices of petrol in regional and metropolitan areas when freight is excluded, apart from WA.

Chart 22 summarises the differences between regional and metro prices (excluding freight) for the five largest states for the period since July 2005. Apart from WA, the difference typically varies between zero and 4 cpl, and about 2 cpl on average.

and about 2 cpl on average.

This is probably significantly less than popular perceptions but these may be shaped by media and other attention on towns with large price differences, not those that have highly competitive pricing.

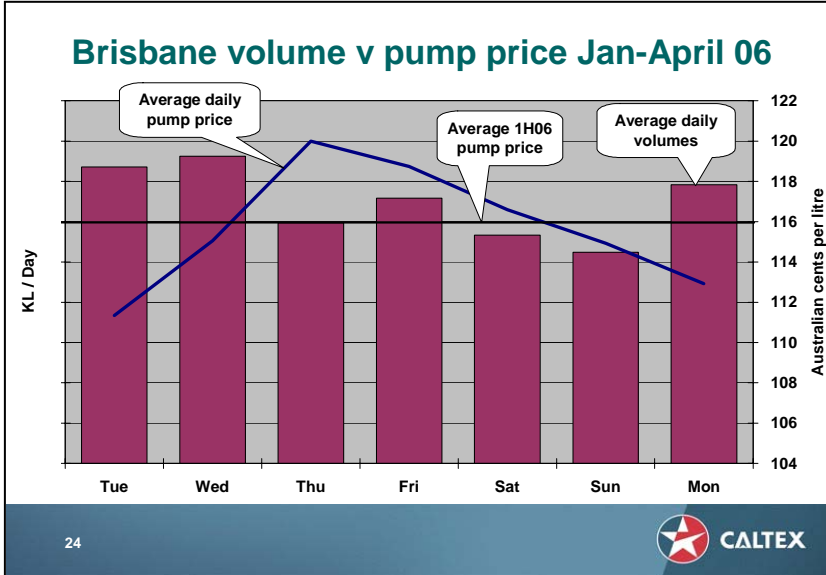
There is also a tendency to compare relatively stable country prices with the low points of metro discount cycles, which may be near or even below cost. The much larger difference in WA may be attributable to the greater remoteness and smaller size of many WA country towns and consequent higher unit costs.

## Term of reference (c)

### Variations in the retail price of petrol at particular times

#### Price cycles

Chart 24



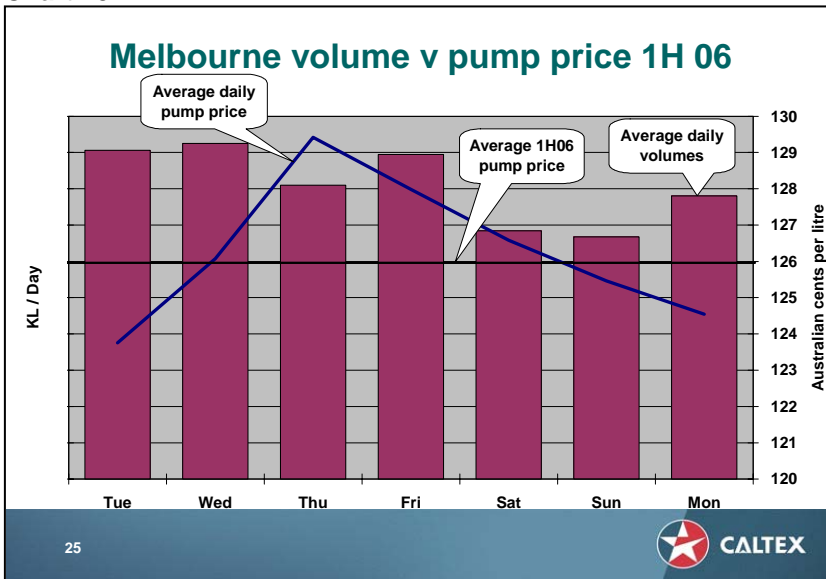
**Daily petrol sales respond to price cycles, to the benefit of consumers.**

Petrol prices in many metropolitan areas vary in a weekly cycle. (These cycles are shown in charts 32 to 38, which discuss prices around long weekends.) The pattern is not absolutely consistent from week to week and there may be periods where discounting continues over two or more weeks.

However, according to the ACCC web site, prices in Brisbane, Sydney, Melbourne and Adelaide in March to June 2006 typically were lowest on a Tuesday and highest on a Thursday, with Wednesday by implication being a day of transition from low to high prices. For Perth, prices were most commonly lowest on a Sunday and highest on a Wednesday.

Caltex has charted average Caltex prices by day of week for Brisbane for January to April 2006 and Melbourne from January to June 2006.

Chart 25



The charts show the highest average Caltex prices on a Thursday and lowest on a Tuesday, which is consistent with the ACCC data for March to June.

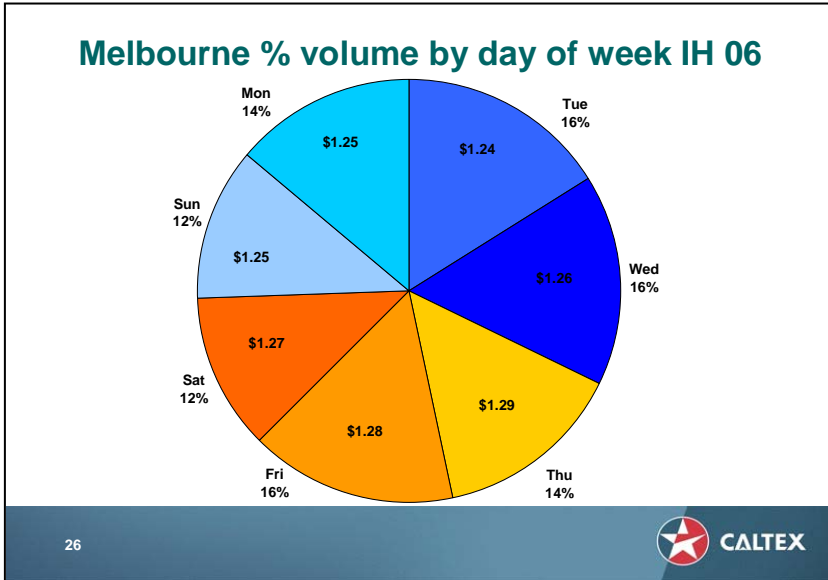
Also shown on charts 24 and 25 are average Caltex daily sales volumes, with the Y axis for volume starting at zero. (Actual volumes are shown in the confidential appendix.) It can be seen that Caltex volumes are highest on Tuesday and Wednesday when prices are lowest and fall sharply on Thursday when prices have cycled upwards. Weekend volumes are lower despite lower prices, probably reflecting the closure of most businesses.

The daily volumes show that motorists are sensitive to prices and modify their purchasing behaviour to take advantage of price cycles. It is therefore reasonable to conclude the weekly

price cycles typical of many metropolitan areas benefit many consumers who wish to take price into account in their purchase decisions.

Contrary to some assertions, prices do not increase to “take advantage” of higher petrol demand on weekends. In fact, both prices and volumes are lower on weekends than other days of the week.

**Chart 26**



**About 55% of petrol is sold on low-priced days of the week in the three east coast capital cities compared with high priced days.**

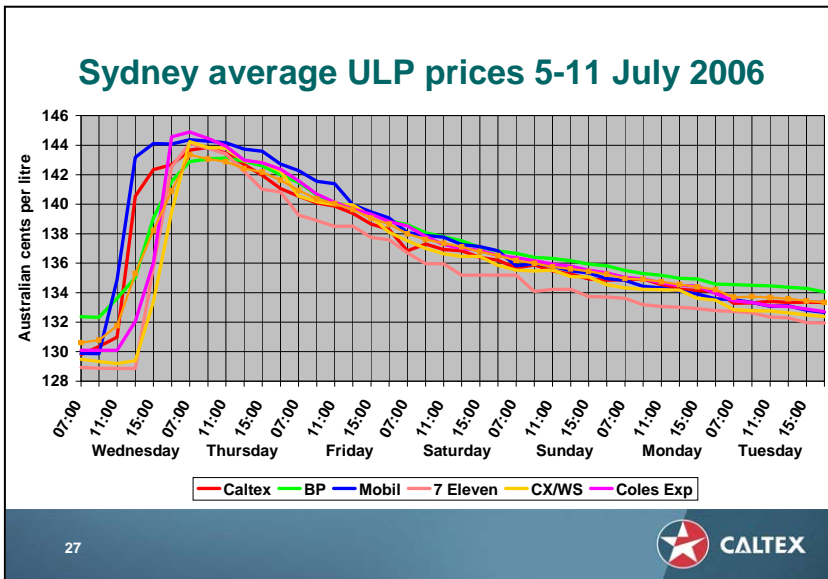
Chart 26 is based on the same data for Melbourne as Chart 25 but shows sales volumes by day as a percentage of weekly sales. The volume in the three days preceding Thursday – these are the lowest priced days of the week – is 54% of the weekly total. The volume in the three days after

Thursday totals 46%.

Another way of expressing this data is that about 16% more petrol is sold in Melbourne on lower priced days than on higher priced days.

Price sensitive motorists can save money by watching the price cycle and, if they can, buying petrol when it is cheaper – this is typically Tuesday in large metropolitan areas. In Perth, Sunday is typically the best day to buy.

**Chart 27**



**Petrol prices don't all increase at the same time and there is no collusion – only fierce competition that benefits consumers.**

Petrol prices are often discounted in major capital cities – and heavily – as a result of intense competition for customers. Service station dealers concentrate on petrol discounting to drive overall petrol sales volumes and associated shop sales.

Supermarkets also use low petrol prices and shopper dockets to drive supermarket sales.

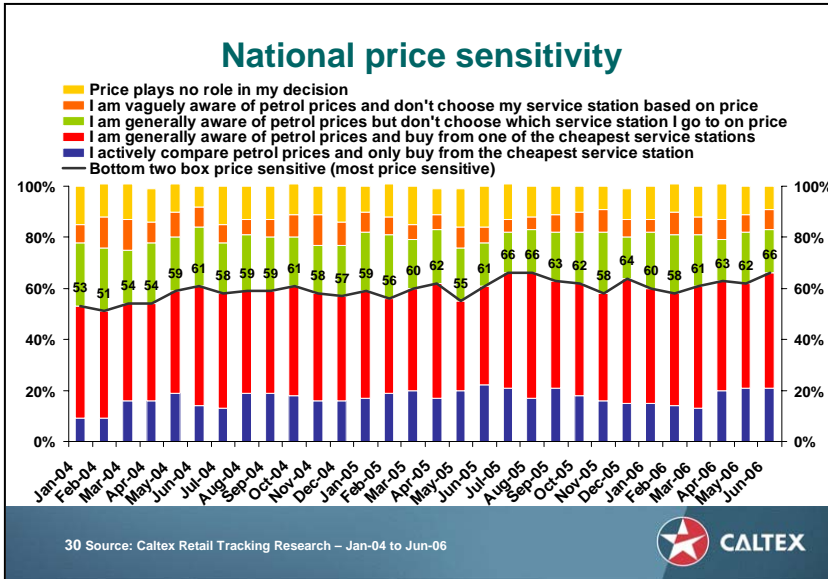
Petrol prices don't all increase at the same time - but sometimes it does look like this because, once a price increase is made by one competitor, other competitors may follow very quickly, as

shown in Chart 27. The data in the chart is from Informed Sources, a consultant specialising in industry price data. Informed Sources is also a supplier of data to the ACCC.

Pump prices often appear to jump up together after they have been discounted heavily for several days. Both discounting and price jumps are the result of a highly competitive and price-sensitive market where competitors' prices are readily visible on price boards.

The ACCC investigated price variability in its December 2001 report and concluded "it is likely that consumers in aggregate benefit overall from price cycles." The ACCC also did not support any of the options it considered to limit price cycles as it was concerned that any such intervention could have the effect of increasing prices.

**Chart 30**



**60% or more of consumers take price into account when buying petrol.**

Caltex research, summarised in chart 30, shows about 60% of consumers (66% most recently) are price sensitive – about 20% actively compare prices and only buy from the cheapest service station and about 40% are generally aware of prices and buy from one of the cheapest service stations.

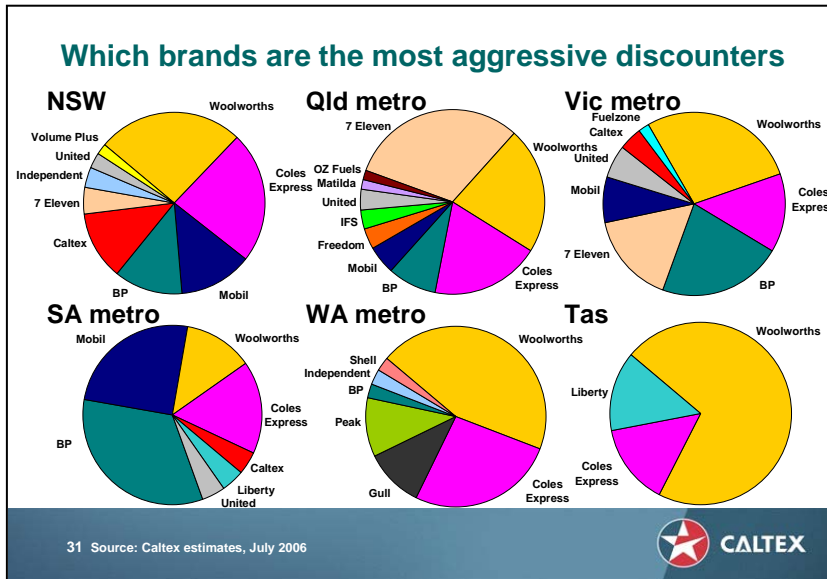
The percentage of consumers taking price into account increases for a short period when prices increase but over time there has only been a small increase in this percentage despite a large increase in prices.

About 40% may or may not be aware of prices but don't use price as a factor in choice of service station (nor, by inference, the day of the week on which they purchase petrol).

The large number of people who shop around on price points to the value of price cycles to those who can time their purchases accordingly but also explains the level of annoyance of those that are not sufficiently aware of the price cycle to avoid days on which prices typically increase. The answer would appear to be greater awareness of cycles by consumers rather than eliminating cycles through market intervention, as has been attempted in Western Australia.



Chart 31



The supermarket alliances operate the largest number of service stations that are aggressive discounters. In most markets, non-major oil company brands play a minor role.

Chart 31 shows the results of Caltex research in 284 market areas across Australia where the brand of service station that has historically been the most aggressive discounter was identified.

It shows Woolworths and Coles Express sites were identified as the most aggressive discounters in a majority of markets. This is more significant when the relatively limited number of sites under these brands is taken into account (about 20% of the national total number of sites). Both Woolworths and Coles Express rely on petrol sales to drive supermarket sales through their shopper-docket redemption offers.

All Woolworths sites are co-branded Caltex (for fuel) and Woolworths (for the shop) but prices are set by either Woolworths or (for Caltex-contributed sites) Australian Independent Retailers Pty Ltd under the direction of Woolworths. Coles Express sites are co-branded Shell.

BP and 7-11 metro sites (both commission agency operations) in Victoria and Mobil (franchised) and BP in South Australia also had a significant number of aggressive discount sites.

### **Petrol prices and public holidays**

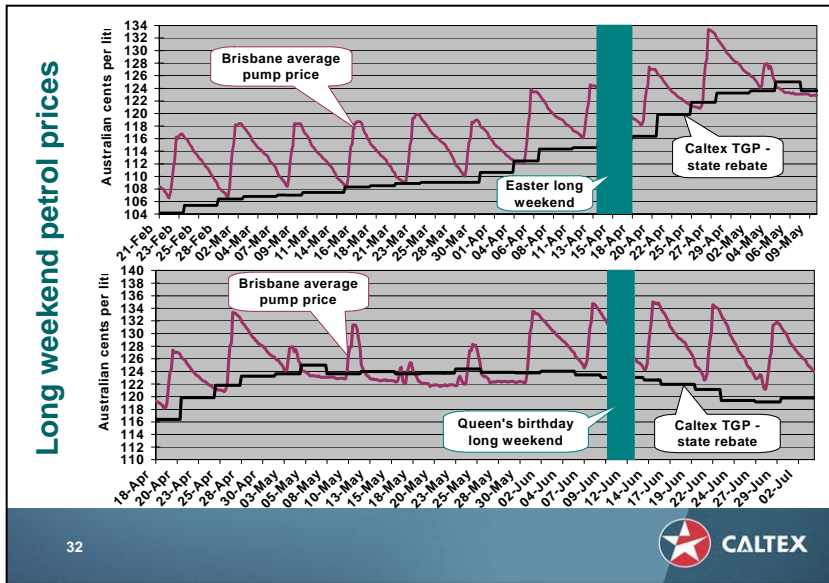
#### **Prices do not jump because of long weekends.**

In the lead up to, and throughout, holiday long weekends pump prices follow their typical weekly cycles. This normal behaviour is typical of all holiday periods in major metropolitan areas.

The following series of charts for capital cities show that contrary to the assertions of some commentators, pump prices did not jump up because of the Easter or Queen's Birthday (June) holiday weekends in 2006.

In each chart, the pump price at the trough of the cycle is typically similar to the terminal gate price ie. the bulk wholesale price ex-terminal. Pump prices at the top of the price cycle could be 10 cpl or more above TGP, although these prices are rapidly discounted over the course of the week and sometimes two weeks or more.

Chart 32 - Brisbane



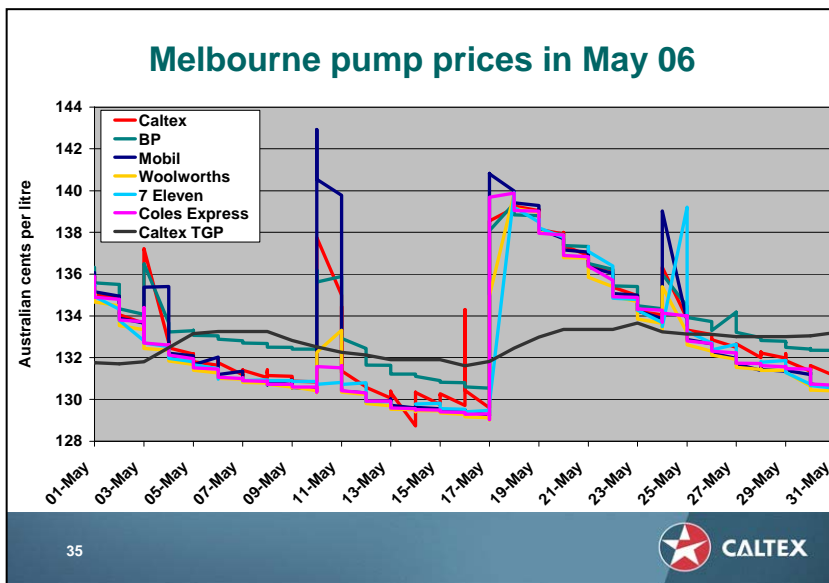
**Brisbane prices did not jump because of long weekends.**

In Brisbane the price cycle was normal before, during and after the Easter long weekend.

A similar pattern was exhibited up to and over the Queen's Birthday long weekend in June, the only difference being that there was intense discounting during three weeks of May (this was common to other cities). This meant that when the price cycle returned to normal 10

days prior to the June long weekend, the peak of the cycle, while in the normal range (ie. as experienced historically – a peak pump price relative to TGP of 10cpl or less) increased pump prices around 12cpl because of the previous discounting below TGP.

Chart 35 – Melbourne (detail)



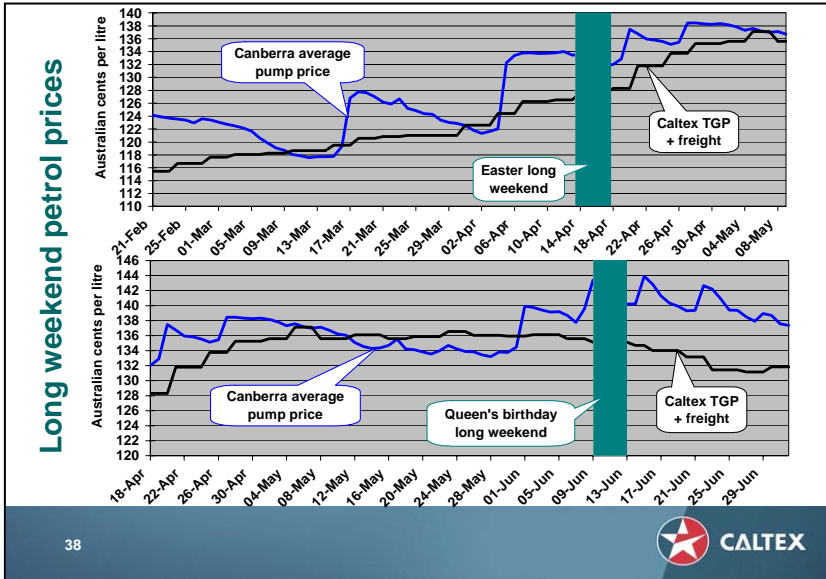
**Coles and Woolworths drove discounting well below TGP in May in Melbourne and many other cities.**

Chart 35 shows the average pump price by brand during May against Caltex TGP (used here as an indicator of spot market wholesale petrol prices). It indicates that the intense discounting (where petrol was sold below TGP) was driven by Woolworths and Coles and followed by most other major brands.

Brisbane, Sydney, Melbourne, Adelaide and Canberra all experienced this intense discounting driven nationally by the supermarket alliance sites.

This period of intense discounting could be due to a number of factors. Most notably April saw a steep decline in the volume of petrol sold nationally compared with March (10% drop) due to the sharp increase in price (Caltex TGP increased by 7%) – see Chart 5. Both Woolworths and Coles rely on petrol sales to drive supermarket sales through their shopper-docket redemption offers. By reducing their profits from petrol, or eliminating them for a short time, they can increase their supermarket sales volumes and also their relative petrol market shares. It therefore is possible that both supermarket chains drove petrol prices down in May to recover from poorer sales in April, with inter-company rivalry adding to competitive pressure to lift sales.

Chart 38 - Canberra



**Canberra prices did not jump because of long weekends.**

Canberra does not follow the same weekly price cycle as other cities. However, it does have a pattern of discounting followed by sharp price rises then slow falls but cycles when they occur tend to last longer than one week.

The sharp price increase that occurred 10 days before Easter was more visible in Canberra

because of the long cycles that are historically typical of the city. These long cycles mean that pump prices decrease over a period of two weeks so the shock is greater when the cycle peaks as it occurs less regularly than in other cities.

The perceived jump ahead of the June long weekend followed 20 consecutive days of discounting in which prices were well below TGP. This level of discounting was unsustainable and pump prices returned to their typical pattern following discounting of sharp price rises and then slow falls. Prices increased as part of this pattern 10 days prior to each long weekend.

**Term of reference (d)**

**The industry's integrated structure**

**Chart 45**

<u>Controlling entity</u>	<u>Number of sites controlled**</u>
Major oil companies*	238
Supermarkets (includes Caltex Woolworths and Coles Shell sites)	1040
Franchisees – major oil company brands	800
Independent sites – major oil company brands	3900
Other brands (eg. 7-11, United, IFS, Neumann)	600
	<hr/> 6600

**The petroleum industry is not highly vertically integrated.**

Chart 45 shows there are few sites directly operated by major oil companies. There is large number of independent sites, over half the total.

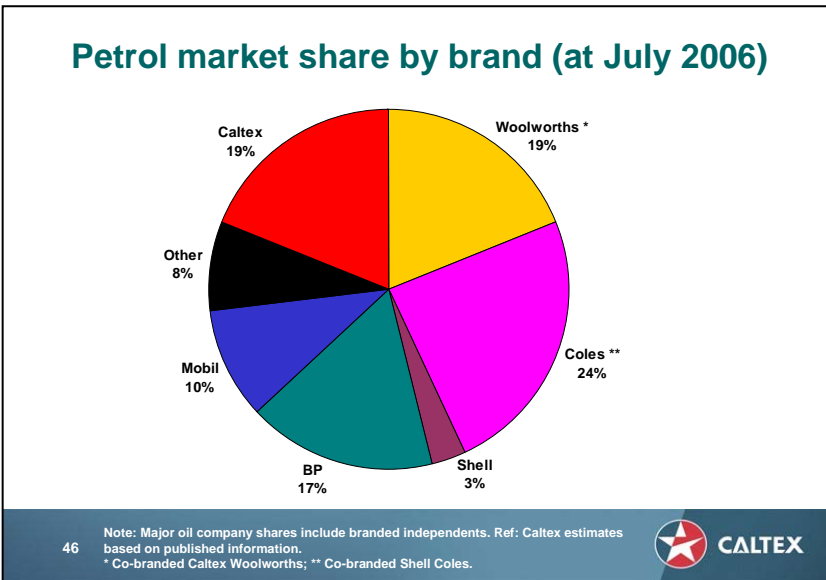
Supermarkets operate about 20% of sites and franchisees (of which Caltex has by far the largest number) operate about 10% of sites.

Although the data is from

2004 data the picture would be similar today. On this basis, the retail sector is not highly concentrated nor highly vertically integrated.

At the bulk wholesale level, seven refineries owned by four major oil companies buy and sell fuel and there are a number of importers and import terminal operators including Gull, Neumann Petroleum, Trafigura and Vopak. At the wholesale level, apart from major oil companies, wholesalers include Neumann Petroleum, Gull and Liberty.

**Chart 46**



**Supermarkets have 43% volume share of petrol market.**

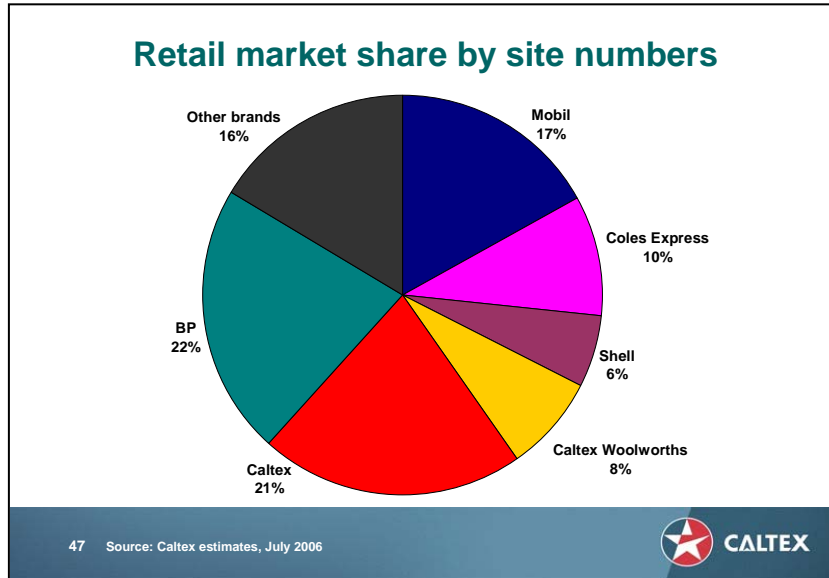
Chart 46 shows petrol market share by brand across Australia. There are four major competitors of similar size on a national basis. The fifth major competitor, Mobil, is of similar significance to these four competitors in the states where it has concentrated its operations. For Australia, this is not a concentrated market and competition is vigorous. There are also several smaller but

significant chains operating in particular states.

The brand market shares are based on total sales from all sites that display a company's brand, not who operates the sites. Very few branded sites are operated by the four refiner-marketers; sites may be operated by franchisees, commission agents or independents as well as by the major oil companies themselves.

The combined share of the two supermarket competitors, Woolworths and Coles, is 43%. This is less than the 50% or more commonly stated in the media as that number appears to mistakenly include Caltex's share with Woolworths. All Woolworths sites are co-branded Caltex (for fuel) and Woolworths (for the shop) but prices are set by either Woolworths or (for sites contributed by Caltex to the Caltex Woolworths venture) Australian Independent Retailers Pty Ltd under the direction of Woolworths.

**Chart 47**



**The major oil company brands appear on the largest number of service stations but most are operated by franchisees, supermarkets or independent site owners.**

Chart 47 shows market share by site numbers. This includes many independently operated sites carrying major oil company brands as well as franchised sites.

Coles Express and Caltex

Woolworths have relatively few sites however a large market share by volume.

**Term of reference (e)****Any other related matters****Biofuels****Chart 48**

	Case 1	Case 2	Case 3
Singapore petrol price (US\$/barrel)	85	65	40
Landed price (incl. quality premium) plus terminalling cost, wholesale margin and freight (acpl)	84	68	48
plus retail margin	3	3	3
plus excise	38	38	38
plus GST	12	11	9
Total retail price acpl	137	120	98
Memo: wholesale price + tax (excl GST) acpl	122	106	86

Petrol price decreases 0.8 cpl per 1 US\$/barrel Singapore price decrease (159 litres/barrel)  
Ethanol wholesale prices (excluding GST and freight) estimated 80 cpl (high case), 60 cpl (low case).  
Ethanol price comparison must include allowance for freight from ethanol plant to petrol terminal and E10 infrastructure cost recovery (terminals and service stations)

48



**Ethanol is competitive at current oil prices.**

Chart 48 shows a typical build-up of wholesale and retail petrol prices from the Singapore price. At an assumed Singapore petrol price of US\$85 per barrel, the resultant pump price (average over a week) is 137 Acpl. At US\$40 per barrel, the pump price is 98 cpl. Corresponding wholesale prices (excluding GST) are 122 Acpl and 86 Acpl. The table is based on the current US\$/A\$ exchange

rate of about 0.75.

The high case is similar to prices in July 2006 and can be used as an example to work through ethanol economics.

From the viewpoint of a theoretical service station faced with the choice of purchasing E10 or straight petrol, the wholesale petrol price is 122 cpl and ethanol about 80 cpl (both excluding GST), a difference of about 40 cpl, or 4 cpl in a 10% blend. In reality, the advantage is not so great as ethanol delivery is typically more expensive due to greater distance from the plant and an allowance needs to be made for amortisation of terminal upgrades to blend ethanol and service station conversion costs for E10. Assuming these items come to 10 cpl, the cost advantage of E10 is about 3 cpl, quite significant compared with a typical metro area gross retail margin of about 3 cpl.

Actual pricing of E10 versus regular unleaded petrol (ULP) will reflect local competition, including competition from other service stations selling E10. With relatively few service stations selling E10, some service stations may choose not to discount E10 in order to shore up retail margins, which are under great pressure in most metro and many country markets. Other service stations may choose to discount E10 relative to ULP to build sales volumes of all petrol. As the E10 market develops, pricing is likely to reflect the change in competitive conditions.

However, Caltex announced on 10 August 2006 that it had put in place pricing arrangements for its E10 Unleaded petrol to be sold at 3 cents per litre (cpl) less than regular unleaded petrol. The 3 cpl discount would apply at all company-operated sites and also at wholesale to resellers.

In conclusion, E10 therefore *may* reduce petrol prices – as at present - but given the reduction of the ethanol cost advantage with lower oil prices, government policy should not rely on E10 as a mechanism to reduce petrol prices in the long term.

**Conclusion**

Caltex reiterates that we support the continuation of an unregulated petroleum products market in the belief that the current arrangements provide the best environment to encourage the large on-going requirements for capital investment in the industry and the maintenance a secure supply of transport fuel for Australia.