

Responses to Questions from Minority Shareholder Watch Group (MSWG) during Hengyuan Refining Company Berhad's 64th Annual General Meeting

Operational and Financial Matters

Question 1:

Notwithstanding the Company recorded a higher revenue in FY 2022, its gross profit fell to RM0.3 million (FY2021: RM1,044.7 million) affected by the higher plant production downtime, increased crude premium, and softening of Mogas cracks mainly in the second half of the year. (Page 41 of AR)

(a) Please quantify in value the impact of higher plant production downtime, increased crude premium and softening of MOGAS cracks respectively.

HRC's Response:

The above highlighted factors have led to the following impacts:

- I. Sales volume, especially for higher margin gasoil/mogas products, fell for two straight consecutive quarters in the second half of 2022, with a reduction of 14.5% in Q3 2022, and further decline of 4.4% in Q4 2022.
- II. Crude premium increased significantly above USD13 per barrel in second half of 2022 and reached a peak of USD18 per barrel in August and September 2022 against the average crude premium cost of approximately USD6 to USD8 per barrel during the first half of 2022. The cause of this increase was due to the Russia-Ukraine conflict.
- III. Mogas cracks in Q2 2022 was at USD29 per barrel before dropping significantly to USD9 per barrel in Q3 2022 and further declined to USD6 per barrel in Q4 2022, which eroded the refining margins of the Company.

(b) What measures have been taken to minimize production downtime in the future?

HRC's Response:

HRC has an ongoing rigorous maintenance schedule, to optimize plant efficiency and minimize downtime. The next scheduled planned turnaround (TA) is in 2023. Management is continuously working to minimize production downtime.

Question 2:

Based on the assessment on the net realizable value of the hydrocarbon inventories performed, the Company has provided RM124,924,000 (2021: RM41,935,000) for inventories write down. (Page 115 of AR)

(a) What were the reasons for the huge hydrocarbon inventories write down in FY 2022?

HRC's Response:

The Company's accounting policy on NRV can be referenced to in Note 3(c) on page 115, Note 2.12 on page 108 and Note 16 on page 131 of our 2022 Annual Report, which sets out the factors that are taken into account in determining the NRV.

The current NRV write down mainly arises from the changes in forecasted product prices as compared to the carrying amount of inventory as at 31 December 2022. The write-down complies with the accounting standards and has been subjected to external audit.

(b) What is the risk mitigating measures taken by the Company to ensure that high inventories write-down can be minimized?

HRC's Response:

Management continuously optimizes inventory levels to meet the production requirements. The future price of inventories at year end is determined by market factors.

Question 3:

Derivative financial liability from commodity swap contracts has increased substantially to RM839.8 million in FY 2022 from RM187.1 million in FY 2021. (Pages 121 & 122 of AR)

(a) What were the reasons for the huge increase in derivative financial liability from commodity swap contracts in FY 2022?

HRC's Response:

The huge increase in derivative financial liability is due to higher mark-to-market valuation that resulted from wider crack spread in the market.

The wider than expected crack spread was the result of the Russia-Ukraine conflict.

(b) What is the potential risk of such increases to the Company?

HRC's Response:

The derivative valuation is subject to fluctuations in crude oil and prices of refined products. Depending on the valuation position, it is reflected in the value of the Company's assets or liabilities. The cashflow and counterparty risks are actively being monitored as part of the Company's risk management process.

Post year-end, there has been a drop in crude prices and the liquidity risk has correspondingly decreased.

(c) Will the Board impose a limit on derivative commodity swap contracts so that it will not impose a risk to the Company?

HRC's Response:

We are guided by our existing hedging policy and strategy, which is reviewed on a periodic or as-need basis, so it remains relevant. In addition, our hedging position is continuously evaluated by the Management and Board.

Question 4:

The Company's borrowings due within 1 year is RM1,042 million in FY 2022 as compared to RM486 million in FY 2021, an increase of RM556 million or 114.4%. (Pages 119 & 120 of AR). Resulting from this, the Company's gearing ratio has increased to 54% in FY 2022 from 28% in FY 2021.

(a) Why did the company borrow RM1,042 million for the short term (due within 1 year) and not on a much longer term?

HRC's Response:

The refinancing programme renewal, announced to Bursa on 12 September 2022, enables the Company to raise short term borrowings i.e., through multi-currency revolving credit facilities (of up to USD235 million and RM250 million respectively) and MTN programme (of up to RM5.0 billion in nominal value over 30 years). Most of the short-term borrowings drawn down under the refinancing programme are revolving credits (RM927.5 million), which are subject to yearly renewal. The purpose of the short-term borrowing is to meet working capital requirements, especially crude payments and a provision for the upcoming maintenance projects (i.e MTA2023)

(b) What is the purpose of the RM1,042 million borrowing?

HRC's Response:

The purpose of the short-term borrowings is to meet working capital requirements, especially crude purchase and a provision for upcoming maintenance projects (i.e MTA2023)

Question 5:

A national power failure on 27 July 2022, which resulted in an unplanned shutdown for several hours, and the subsequent need for corrective maintenance, impacted the plant's production availability in the second half of 2022. This had a significant effect on the year's production volumes. (Page 4 of AR)

(a) What was the impact to the production volume in term of quantity and value resulting from the national power failure?

HRC's Response:

The impacts of the national power failure are as mentioned below:

- I. Reduction in production volume reduced by 14% from Q2 to Q3 2022, and further declined by 6% in Q4 2022.
- II. Change in production composition resulting in lower available sales volume of gasoil and mogas by 22% and 18% respectively.
- III. The consequential impact on value is the combined result of multiple factors including volume, product mix and market forces. The combined sum of these resulted in a decline in sales value by 21.6% in H2 2022 vs H1 2022.

(b) What mitigating measures have been taken to ensure that any power failure in the future will not have a significant impact to the Group's production volume?

HRC's Response:

The plant, being a complex refinery, requires continuous high quality power input, which can only be obtained through the national grid. Management is proactively engaging TNB to ensure continuous reliable supply.

(c) What was the additional cost incurred to startup the production as a result of the power failure?

HRC's Response:

The consequential impact of the shutdown resulted in production issues as described above. In addition to the impact on plant efficiencies, additional consequential impacts include the need to divert crude purchased and buy-in volume to fulfill our sales commitment.

(d) Can the Company claim compensation from Tenaga due to the power failure? If yes, what is the expected amount?

HRC's Response:

As electricity was restored within the Service Level Agreement timeframe, the compensation clause could not be triggered.

Question 6:

One of the Tier 2 Process Safety Events (PSE) was due to a shutdown activity that resulted from incorrect instrument reading. (Page 35 of AR)

(a) Please explain the significance of API Tier 2 Proceed Safety Events.

HRC's Response:

Tier 2 PSE is a Loss of Primary Containment (LOPC) or fire with lesser consequence e.g., fire or explosion causing \$2,500 or more in direct cost. LOPC is an unplanned or uncontrolled release of any material, including non-toxic and non-flammable materials, from a process that results in consequences or have potential to cause consequences to personnel, the environment, and the surrounding community. By identifying and analyzing Tier 2 events, HRC can learn valuable lessons and implement preventive and corrective measures to enhance safety, reduce risks, and improve operational practices.

(b) Is this the first time that such an accident has happened?

HRC's Response:

This is the first time that such an incident has occurred, and it is a consequence of the re-startup post national power outage.

(c) Please quantify production loss due to this shutdown.

HRC's Response:

There was a significant loss of 2.5 days production days prior to re-startup.

(d) What measures have been taken to ensure that the risk of this happening again is mitigated?

HRC's Response:

Following the incident, a detailed investigation was carried out and proactive measures have been put in place to mitigate as much as possible similar incidents.

Below were the action points from the mitigation plan:

1. Introduced additional alarm setpoints during shutdown and pre-feed in for prior indication on the level build up in the column. This is an additional barrier to the level readings.
2. Updated the operational working practice on the requirement to proactively and more stringently verify the level reading based on the level sight glass.

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