ENERGY

Z Energy bondholders' report

For the six months ended 30 September 2011

The market is tough but we continue to outperform our competitors.

CEO review

Dear bondholder

I am pleased to provide you with an update on Z Energy's performance for the first six months of the 2012 financial year.

In July of this year, Z Energy successfully completed its second retail bond issue, raising $150 million through which we have restructured our corporate debt profile, paid down bank debt, extended debt maturities, and built strength and operational flexibility into our balance sheet.

We now have $297 million that has been entrusted with us from retail bond investors around New Zealand. As well as providing us with strength and flexibility, this investment also comes with a great sense of responsibility to investors like you.

Our bondholders are partners in our business and we are committed to ensuring that we are transparent, open and that we provide you with the information you need to understand the business in which you have invested.

This report provides detail on our first half-year performance from a financial perspective, as well as a summary of the performance of our main business operations and an update on some key developments over the course of the year so far.

Over the first half of the 2012 year, we have started to make good progress on our five year strategy. Market conditions have been challenging with higher fuel prices dampening demand and strong competition keeping margins at a very low level.

Against this context, our company has continued to outperform our competitors. While the overall fuels market has declined slightly, Z Energy has managed to gain market share against our competitors, particularly in the commercial diesel markets.

Our commitment to replace the Shell brand across New Zealand with our own Z Energy brand is based on strong market research and a very successful 10 site pilot project. We now have the confidence that we can tell a compelling local story, do a better job than our multinational competitors, and continue to grow and deliver investor value in a highly competitive market.

We expect the downstream fuels sector in New Zealand to continue to change and evolve over the coming years, with opportunities arising for flexible, nimble local companies.

Through our strategy work which has enabled a deeper understanding of our business, the strength of our financial position and the increasing support of customers, Z Energy is well positioned for growth.

Thank you again for your support.

Mike Bennetts

Z's commercial business

Diesel sales are typically a performance indicator of the commercial side of the business – the business-to-business sale of fuel to large commercial operators. It is also a marker for more general activity within the national economy.

In this respect, Z's relatively strong performance in diesel sales for the first half-year bodes well for Z's full year earnings.

Total industry diesel volumes increased by 2.5 per cent over the six months to the end of September compared with Z's volumes which increased by nine per cent. Typically, fuel volumes increase in the second half of the financial year, driven by seasonal activity such as agriculture and fishing in the commercial space, and road travel in the summer months in the retail market.

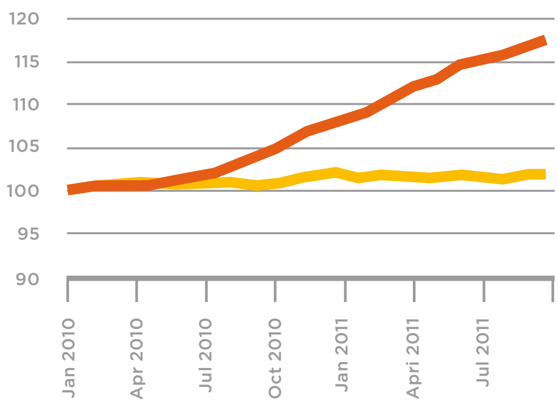
Half of Z's total fuel volume goes through the commercial channel and so understanding customers, their needs and Z's own approach to pricing is vital to delivering the best value from this part of the business – both to customers and to Z.

As part of the strategy development work which started with the acquisition of the Shell business in April 2010, the company has now completed a review of Z's portfolio of commercial customers and identified areas where operating and funding costs are not adequately covered by Z's revenue.

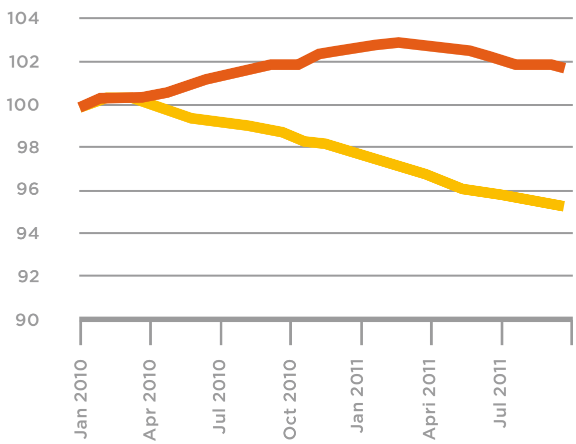
Through investing time in developing a thorough understanding of the business, Z will continue to take steps to improve the economic sustainability of the aforementioned parts of the commercial business over the remainder of the financial year.

> "Half of Z's total fuel volume goes through the commercial channel..."

Diesel volumes
all channels



Petrol volumes
all channels



Z **Industry** (excluding Z)

Z's retail business

As diesel is the marker product for Z's commercial business, so too is petrol a good indicator for retail performance.

Given retail customers have a greater degree of discretion over fuel consumption as opposed to 'must run' commercial fleets, there can be greater price sensitivity in the retail sector that effects consumer behaviour.

This is what Z has observed over the first half of the 2012 financial year. It is clear that the $2 per litre price point for petrol influences driving behaviour, with total industry petrol volumes over the six month period declining by 4.8 per cent year-on-year.

In this context, Z's petrol volumes were down 1.5 per cent on the same period in 2010, showing that while volumes have declined slightly, the company continues to improve its market share position and outperform the industry.

As with the commercial sector, retail volumes typically increase during the warmer second half of the year. Z's improving market share in both petrol and diesel position the company well for a return to economic growth and an upswing in volumes.

Over this period, Z has also made good progress against its retail strategy. A key strategy goal in the retail business is speed; Z's customers want a swift experience at retail sites.
To this end, Z has committed $10 million to a state-of-the-art point of sale system which will replace the current obsolete system and cut electronic transaction times by more than two thirds.

The progressive rollout of the fastest electronic point of sale system in the industry, combined with Z Energy's forecourt service commitment, will see significant efficiency gains and a much improved customer experience at Z sites.

In discussing retail performance, it is worth reflecting on Z Energy's loyalty programme. Z owns 25 per cent of Loyalty New Zealand, the company behind Fly Buys, and is the only fuel company that can offer New Zealand's most popular loyalty programme.

For the first time in a long time, New Zealand is now seeing two of Z's competitors trying to design loyalty programmes of their own. While Z welcomes competitors starting to acknowledge the importance of trying to earn customer loyalty, Z believes Fly Buys is the most effective and popular loyalty programme in the world and remains a key plank in the Z retail offer.

Additionally, Fly Buys is simple to use, rewards are cumulative and the programme incorporates more than 50 regular purchase partners including New World, BNZ, State Insurance, Air New Zealand, Contact Energy and of course, us; Z Energy.

Some key loyalty statistics

724,184 rewards

in the past year that Fly Buys have awarded to half a million Kiwis

Every 46 seconds

someone in New Zealand received a reward

2.4 million

customers collecting Fly Buys points in New Zealand

Over 75%

of households are using Fly Buys. That's one of the highest percentages for a loyalty programme in the world.

Z also redeems discount dockets.

The Z brand

The decision to replace the Shell brand across New Zealand with a new Kiwi brand that speaks to local ownership is the most visual representation of the restructuring that is now occurring in the New Zealand fuels industry. It is also one of the biggest rebranding commitments in New Zealand in recent history.

The decision to effectively develop, build and own the company's identity, rather than 'rent' it from Shell, also lies at the heart of Z's goal to become a world-class Kiwi company.

The Z brand was announced in May and over the six months in review, 10 Z pilot sites were launched in various parts of the country. These stores feature all the elements of the new Z offer for top tier sites; espresso coffee, top quality locally made pies and cupcakes, upgraded bathrooms, guaranteed forecourt service between 10am and 5pm, and a commitment to contribute $5,000 per site to community groups and initiatives as decided by customers.

Over the period of the 10 site trial, Z actively sought customer feedback and tracked how the brand was reaching the public. For a 16-week-old brand, the results from both feedback streams were very encouraging, with a high level of brand recognition and overwhelmingly positive customer experience feedback.

On 3 November, Z informed the market that it was committing to the rollout of the Z brand across the country over the following seven months, completely replacing the Shell brand. The top 100 retail sites will receive a full shop refit and will host all elements of the Z offer. In most cases, the refit will take longer than the rebranding exercise and decisions will be progressively made as to the level of investment in refitting the smaller, second tier Z sites which may not require the full coffee and convenience offer.

All Z sites will feature the company's forecourt service promise between 10am and 5pm, which are the hours customers told Z they most want this available. All 220 retail Z sites will also donate $5,000 to local community groups and projects that matter to the local neighbourhood.

The decision to replace one of the world's biggest and most established brands with something new and local was very carefully taken. It was informed by one of the largest industry-specific pieces of consumer research in New Zealand in recent times and is a reflection of Z's commitment to delivering a better experience for Kiwi customers.

You can see detail of the Z brand rollout announcement, as well as when Z will be arriving in a community near you, at www.z.co.nz. Z will continue to seek feedback from customers and continually refine its offer as a result.

Feedback is encouraged:

Z's website:
www.z.co.nz

Z's facebook page:
www.facebook.com/zenergynz

Z's twitter page:
www.twitter.com/zenergynz

Email:

General comments and observations:
general@z.co.nz

To the CEO:
mike.bennetts@z.co.nz

To the General Manager of Retail:
mark.forsyth@z.co.nz

To the General Manager of Commercial:
lindis.jones@z.co.nz

Z is committed to investment in the country's fuel infrastructure.

Z and infrastructure

The safe and successful operation of the country's fuel infrastructure is critical to New Zealand's economic success. Yet, as a new local company entering the sector last year, Z felt fuel infrastructure had dropped off the agenda and had little to no visibility.

New Zealand consumes some eight billion litres of fuel products every year, which are imported, refined, sent down pipelines, shipped to bulk storage terminals at the country's main ports, and delivered via trucks to customers and retail outlets.

During Z's initial strategy development process, the company identified gaps in the country's fuel storage infrastructure that Z will endeavour to progressively close through selective investment. During the company's first year of operation, Z learned exactly how tight the country's fuel supply chain had become and immediately took steps to increase its own stockholdings to build greater resilience into its supply chain.

In early November, Z also completed a $25 million, 30 million litre bulk fuel storage facility at the Port of Lyttelton and will invest an additional $40 million in new fuel storage assets across the country over the next three years.

Z believes one of the reasons why investment in fuel infrastructure has been rationalised and reduced over previous decades is the absence of commercial operating terms for the assets.

Historically, the industry's bulk fuel storage assets were shared among four main participants with roughly equal market share, and the capital costs of the assets were not recovered in access and usage charges.

As the industry has evolved and market share statistics have materially shifted, these historic arrangements are no longer serving the industry or its customers well. Z is committed to the commercial operation of fuel infrastructure assets to enable reinvestment and increase security of supply to customers and the country.

"Z will invest $1.2 million in local neighbourhood projects."

Z in the community

Investing in what matters locally

Z's consumer research found that New Zealanders have much higher expectations of a local company than of multinational companies. Kiwis expect a local company to be straight up with them and to put things right quickly when things go wrong. They also expect a local company to give back to local neighbourhoods.

Z has taken this feedback on board. Over the 2012 financial year, Z has made a number of significant contributions to communities and neighbourhoods, both as part of the company's neighbourhood investment programme and in response to potential disaster.

Z Energy doesn't have a corporate or head office 'sponsorship' budget. Rather, it has decided that it will invest in neighbourhoods around the company's retail sites, in the things customers say matter to them.

During the rollout of the Z brand, Z will invest $1.2 million in local neighbourhood projects. As each site is rebranded, four local groups and initiatives will be selected by each site and customers will vote with a token on how $5,000 is allocated amongst those four groups and initiatives.

Z's role in the Rena recovery

On 5 October, the container vessel Rena ran aground on the Astrolabe Reef off Tauranga, initially leaking around 350 tonnes of heavy fuel oil into the sea which washed up on local beaches, injuring and killing thousands of sea birds.

With more than 1,300 tonnes of oil remaining on board the Rena, the salvage effort immediately focussed on how to transfer the oil off the Rena into a safe vessel.

As part of Z's marine fuel business, the company holds the exclusive charter of the marine refuelling barge, Awanuia. The Awanuia takes fuel oil from the Marsden Point refinery to Ports of Auckland where it is used to refuel large vessels such as cruise liners.

It quickly became apparent that the Awanuia could play an important role in transferring oil from the Rena and Z immediately started to make provisions for releasing the Awanuia from charter to enable her to help.

Over most of the following five weeks, the Awanuia and her crew were at dock on the stern of the Rena, slowly but surely pumping the heavy fuel oil from the Rena and into safe storage tanks. On 13 November, the final fuel oil was successfully pumped out of the Rena's troublesome 'starboard five' fuel tank and the Awanuia was released from service, just in time for the start of the cruise liner season.

The five weeks that the Awanuia was out of service was only made possible through the co-operation and patience of Z's marine customers, a number of whom were inconvenienced by the Awanuia's absence.

Z wants to thank its customers for enabling the Awanuia to play such a critical role in preventing a much worse environmental disaster in Tauranga and also the crew of the Awanuia who put up with incredibly difficult conditions to make such a nationally important contribution.

Financial performance

The financial information in this section relates to the Z Energy Group, being Aotea Energy Limited and its subsidiaries, the Guarantors of the bonds.

Z Energy's operational and financial performance for the six months ended 30 September 2011 and its comparison of the same 2010 period is set out in the adjacent table. In line with a weakening New Zealand economy, the trading conditions have generally deteriorated. However, Z Energy continues to outperform the industry in terms of volume and market share.

For the period ended 30 September 2011, Z Energy Current Cost Earnings EBITDA were $83 million. This measure of earnings is the focus of management and capital providers because it provides insight into the underlying margin performance of the business.

Historic Cost Earnings form the basis of the annual financial statements and the calculation of income tax. Historic Cost Earnings take into account changes in the value of inventory. Fluctuations in oil prices and the USD:NZD exchange rate change the value of Z Energy's inventory and consequently, the Historic Cost Earnings.

Factors that influence earnings year-to-year:

- Changes in oil prices are a source of volatility in reported earnings, the primary impact being on consumer demand.
- Changes in the USD:NZD exchange rate impacts the value of USD revenues and costs. To a large degree, these are hedged but some volatility in earnings arises due to timing mismatches in the revaluation of receivables and payables at each period end.
- Fluctuations in the gross fuel margin impact cash earnings. Economic conditions have generally deteriorated over the past six months and price competition is depressing retail margins. However, we have had strong commercial diesel volumes, albeit at lower margins. Overall gross margin is $2 million greater than the same period last year.
- Operating costs are also a source of earnings volatility. When compared to the period to September last year, operating costs have increased $10 million, mainly due to the investment of $8 million in launching the brand, retail offers and other strategy projects, and an increase of $4 million in distribution costs driven primarily by increased activity.
- Refining margins are also a source of earnings volatility. Refining margins are influenced by global supply of, and demand for, refining capacity. The margin is calculated in USD and is subject to exchange volatility. Year-on-year the New Zealand Refining Company (NZRC) contribution has been stable.

Past performance is not necessarily indicative of future results.

Z Energy Group Pro-forma Consolidated Financial Results for the six month period ending 30 September 2011

	Period ended 30 September 2011	Period ended 30 September 2010
Operational performance		
Sales (million litres)	1,234	1,244
Retail sales as a % of total sales	49%	49%
Average Crude Price	NZ$134/bbl	NZ$107/bbl
Inventory at period end (million litres)	521	452
Inventory Value ($NZ millions)	$542	$379

Financial performance ($NZ millions)		
Revenue (excluding levies taxes)	$1,546	$1,247
Gross margin	$209	$207
Operating costs	($126)	($116)
Current Cost Earnings EBITDA	**$83**	**$91**
Current Cost stock adjustment[1]	($13)	($29)
NZRC contribution[2]	$6	$6
Historic Cost Earnings EBITDA	**$76**	**$68**
Depreciation	($16)	($11)
Hedge Revaluations	$7	($7)
External Interest	($21)	($14)
Tax	($12)	($19)
Asset revaluations[3]	$0	$121
Shareholder Earnings	**$34**	**$138**

[1]The current cost stock adjustment restates the inventory valuation from current to historic cost.

[2]NZRC contribution represents the aggregate of the Group's 17.14% share of The New Zealand Refining Company Limited's net profit before tax plus other comprehensive income before tax of that company.

[3]Asset revaluations represents the fair valuation of assets and liabilities on acquisition on 1 April 2010.

The comparative financial information in this table has been adjusted for certain re-classifications to be consistent with current year treatment.

Z Energy Group Financial Position 30 September 2011

$NZ millions	30 September 2011	30 September 2010
Land, Buildings, Plant and Equipment	468	459
Inventory	542	379
Receivables and prepayments	222	180
Investments in Associates	205	201
Cash and cash equivalents	100	47
Other Assets	8	2
Total Assets	**1,545**	**1,268**
Payables	523	312
Other Liabilities	61	59
Bonds	292	144
Bank Working Capital	0	0
Bank Core Debt	47	195
Equity	622	558
Total Liabilities	**1,545**	**1,268**

Land, Buildings, Plant and Equipment

The Group's $468 million of property, plant and equipment includes:

- Freehold and leasehold land and buildings used as retail service stations and truck stops
- Plant and equipment for use in retail service stations and truck stops
- Storage and distribution infrastructure assets, which include port storage facilities, airport storage and refuelling equipment and pipelines
- Intangible assets, including carbon credits purchased for the settlement of carbon obligations and the right to participate in the Fly Buys loyalty scheme.

Inventories of $542 million recorded at historic cost comprise $246 million of crude oil and $296 million of refined products which cover between two and three months sales. At 30 September 2011, Z Energy had 521 million litres of inventory on hand compared to 452 million litres held as at 30 September 2010. In addition, prices of crude oil have risen compared to the previous period, increasing the value of stock on hand. At 30 September 2011, Brent Oil was NZ$136.95 compared with NZ$109.90 at 30 September 2010.

Receivables are largely made up of amounts due from customers that have been extended credit for sales made to them in the last 30 days. The higher receivables balance as at 30 September 2011 reflects increased oil prices (face value of sales higher).

Payables is largely comprised of amounts owing to Z Energy's suppliers of crude oil and refined products for which title has been received but for which the due date for payment is in the future, and associated taxes and duties.

Investments in Associates includes Z Energy's investment in NZRC, comprising 48 million shares carried at the cost at acquisition plus equity earnings less dividends and Z Energy's investment in Loyalty NZ.

Bank working capital debt represents funds drawn to finance working capital. Z Energy has a $350 million facility which it draws on as required. At 30 September in both 2010 and 2011, the facility was undrawn.

Bank core debt has been significantly reduced after issuance of the bonds. Z Energy has a NZ$203 million revolving debt facility with its banks which, at 30 September 2011, was drawn down by $53 million. Associated transaction fees of $6 million are recorded on the balance sheet and amortised over the life of the debt.

Bond debt is the book value of the Group's $297 million face value of bonds less the costs of issuing the bonds, being $5 million. These costs are amortised over the term of the bonds.

Other asset items include derivatives of $6 million.

Other liabilities include deferred tax liability of $25 million, environmental and decommissioning and restoration provisions of $24 million, Christchurch earthquakes provisions of $3 million and derivatives of $2 million.

Equity increased to $622 million at 30 September 2011 compared to $558 million at 30 September 2010. Z Energy notifies bondholders that a transcribing error on page 24 of the Prospectus dated 29 June 2011 (in the table representing Z Energy Group's (AEL) financial position as at 31 March 2011) resulted in two figures that differed from the correct figures in the audited Statutory accounts that were filed at the same time. They were:

- (a) "Payables" stated as being NZ$360 million, rather than NZ$388 million, and;
- (b) "Equity" stated as being NZ$645 million, rather than NZ$617 million.

The registered and audited financial statements referred to in the Prospectus correctly represented the position.

Compliance with Financial Covenants

Z Energy was in full compliance with all of its financial covenants in relation to the group indebtedness for the reporting period. The key financial ratio for Bondholders measures earnings and debt, and as at 30 September 2011, required that Total Debt (which generally excludes working capital funding) cannot be more than 3.75 times the EBITDA (calculated on a Current Cost basis) of the previous 12 months. The bond covenant is set to be 0.5 higher than the corresponding bank covenant, which is currently 3.25 times the EBITDA of the previous 12 months. At 30 September 2011, the ratio was 2.26:1.

z.co.nz