

ExxonMobil Hong Kong Limited

ExxonMobil Hong Kong Limited ("EMHK") provides the following response to the Panel on Economic Services' (Panel) letter of invitation dated March 1, 2007 in which the Panel members raised concerns about the relative time in which local auto-fuel prices have been adjusted (relative to international crude oil prices) in recent months.

Relationship between the auto-fuel product cost and crude price

Hong Kong, obviously, does not have a petroleum refining industry. Accordingly, the finished petroleum products, including auto-fuel (i.e. motor gasoline and diesel), are imported mainly from refineries across Asia Pacific and product costs are closely related to the commodity price quoted in the Asia Pacific petroleum market. Such costs are well represented by the price reference known as Mean of Platts Singapore (MOPS)¹.

Per publicly available records, MOPS historically shows a similar general trend as crude price, but the dollar value difference between MOPS and crude price is not a constant -- rather is subject to the demand and supply of corresponding refining products.

As indicated in Chart 1, for MOPS Mogas RON 97 unleaded auto-fuel vs the crude price from January 2005 to February 2007, the price gap ranged from US1.2\$/B to US25.6\$/B. The gap was particularly wide during September 05, May - July 06, February 07 when the demand and supply of different commodities exhibited wide disparity. This illustrates the fact that the auto-fuel product cost does not always follow the crude price trend exactly in terms of timing and magnitude. The auto-fuel product cost may increase even when the crude price drops.

If the goal of the Panel is to understand the relationship between pump prices in Hong Kong and product costs, it will be much more appropriate to analyze the pump price changes versus MOPS.

¹ Mean of Platts Singapore (MOPS): Platts, a division of The McGraw-Hill Companies (NYSE:MHP), is one of the world's leading provider of energy information. The Platts Asia Pacific/Arab Gulf Marketscan (referred to as the APAG Marketscan), first published in 1981, is the region's longest running oil daily report. The ApagScan, available 5 days week, is a source of Asia's benchmarks for refined products, or MOPS, MOPJ and MOPAG as commonly known by the market. It reports refined product assessments for FOB Singapore, C&F Japan and C&F Arab Gulf markets. MOPS basically represents "The mean of the high and low components of a Platts assessment for oil cargoes loading from Singapore. Often used as a component in floating price deals" - Source: www.platts.com.

Relationship between pump price, product cost and effective customer purchase price

We begin by referring to the paper from Legislative Council Panel on Economic Services in 2004², the Government's "Study report of the auto-fuel retail market" 2006³, and the written reply by Economic Development and Labour Bureau to Legislative Council dated October 25, 2006, all of which reached a similar conclusion that either "ExxonMobil diesel price has closely tracked the increases and decreases in import prices over recent years"⁴ or "local pump prices of auto-fuel have been broadly in line with trend movements of the international oil prices"⁵. As shown in Charts 2 and 3 - EMHK petrol and diesel pump price changes, while much less frequent than changes of the volatile MOPS, still consistently track the MOPS product cost trend.

Apart from MOPS, we would like to draw the Panel's attention to the fact that the majority of Esso customers are paying a much lower effective purchase price than the listed pump price under various promotion, discount or loyalty programs.

As highlighted in the Study report of the auto-fuel market 2006,⁶ the nature of competition in the Hong Kong auto-fuel market is characterized in terms of loyalty scheme in recent years. Discounts offered have also increased in dollar terms.

To our petrol customers, since our launch of Smiles Driver Rewards program ("Smiles"), EMHK (which operates the Esso service stations in Hong Kong) is constantly reviewing the program to see if our offer is competitive. At present, our Smiles program provides up to 4% discount (HK\$0.52/L)⁷ to our members by means of free petrol redemption.

The offer is further strengthened after the launch of Add On Discount (AOD) promotion in June 2006 which allows our Smiles members to enjoy an additional HK\$0.3/L discount on the top of free petrol redemption. The AOD was later raised to HK\$0.80/L (Aug, 2006) and HK\$0.85/L (Feb 2007). With the said discount factored in, the latest effective purchase price of our Smiles program petrol customers is actually lower than anytime during 2006 (Chart 2).

To our diesel customers, Esso also offers 15% discount to all walk-in diesel customers. In addition, we offer various kinds of fleet/ discount programs to different categories of customers depending on the volume, customer profile and other business consideration. Due to the sensitivity of the data, we are not able to give the details on the customer-specific programs. However, as well known to the diesel market, we have been offering more and more discounts in recent years.

² Legislative Council Panel on Economic Services, "Retail Prices of Oil Products", LC Paper No. CB(1)439/04-05(01) December 2004.

³ "Study report of the auto-fuel retail market" commissioned by Economic Development and Labour Bureau GOHK"³ published in April 2006.

⁴ "Study report of the auto-fuel retail market" 2006 - section 1.3.2 (B) 2nd paragraph.

⁵ Written reply by the Secretary for Economic Development and Labour in the Legislative Council October 25, 2006.

⁶ "Study report of the auto-fuel retail market" 2006 - section 6.2.3.

⁷ Discount is calculated based on Synergy 8000 pump price \$12.98/L on January 9, 2007.

Factors in determining the pump price

Despite the foregoing, we would like to stress to the Panel that the product cost is only one of many factors considered during our pricing analysis and decision process.

The pump price also comprises many other components such as cost of operation, land cost, government rate and rent, station hardware investment, discounts, market demand as well as market competition.

Apart from the subject of the high petrol station land cost, which has been discussed for years, EMHK has invested significantly to upgrade our station equipment in recent years -- e.g. replacement of existing fuel dispensers in order to comply with the latest environmental legislation⁸ and fire service regulations.

On the other hand, based on several factors - most notably the change of Government policy to introduce auto-LPG, increasing cross-border pumping and threat of illicit fueling activities, local retail fuel demand is continuously dropping year by year.⁹ The average station sales/volume is further reduced by the increasing number of petrol stations awarded in government tender in recent years.¹⁰

With the increase in investment fixed cost but lower average station volume, the unit cost per liter auto-fuel is inevitably increasing.

Hence, apart from the product cost, we suggest that the Panel take all of the above factors into consideration during analysis of the pricing situation and competition in auto-fuel markets.

Conclusion

We would like to reiterate that the local retail auto fuels market is highly competitive. Market developments in recent years fully reflect that in a free economy, the market will make necessary adjustments and corrections to achieve fair market conditions to the benefit of consumers. Simply said: the market works, especially if governments let it work. This kind of market economy truly fulfils what the Chief Executive said: "Market Leads, Government Facilitates".

⁸ The Air Pollution Control (Petrol Filling Stations) (Vapour Recovery) Regulation requires all petrol filling stations (PFSs) to complete the installation of vapour recovery systems (recovery systems) in their petrol dispensers by March 31, 2008.

⁹ Per information from Customs, volume through retail service station dropped in recent years.

	Petrol	Diesel
2006 Nov YTD vs 2005 Nov YTD	-2.0%	-2.7%
2005 vs 2004	-3.5%	-4.7%

¹⁰ Petrol station nos. has increased from 176 (early 2004) to 185 (early 2007).

Chart 1 : MOPS (Mogas 97UL) vs Crude

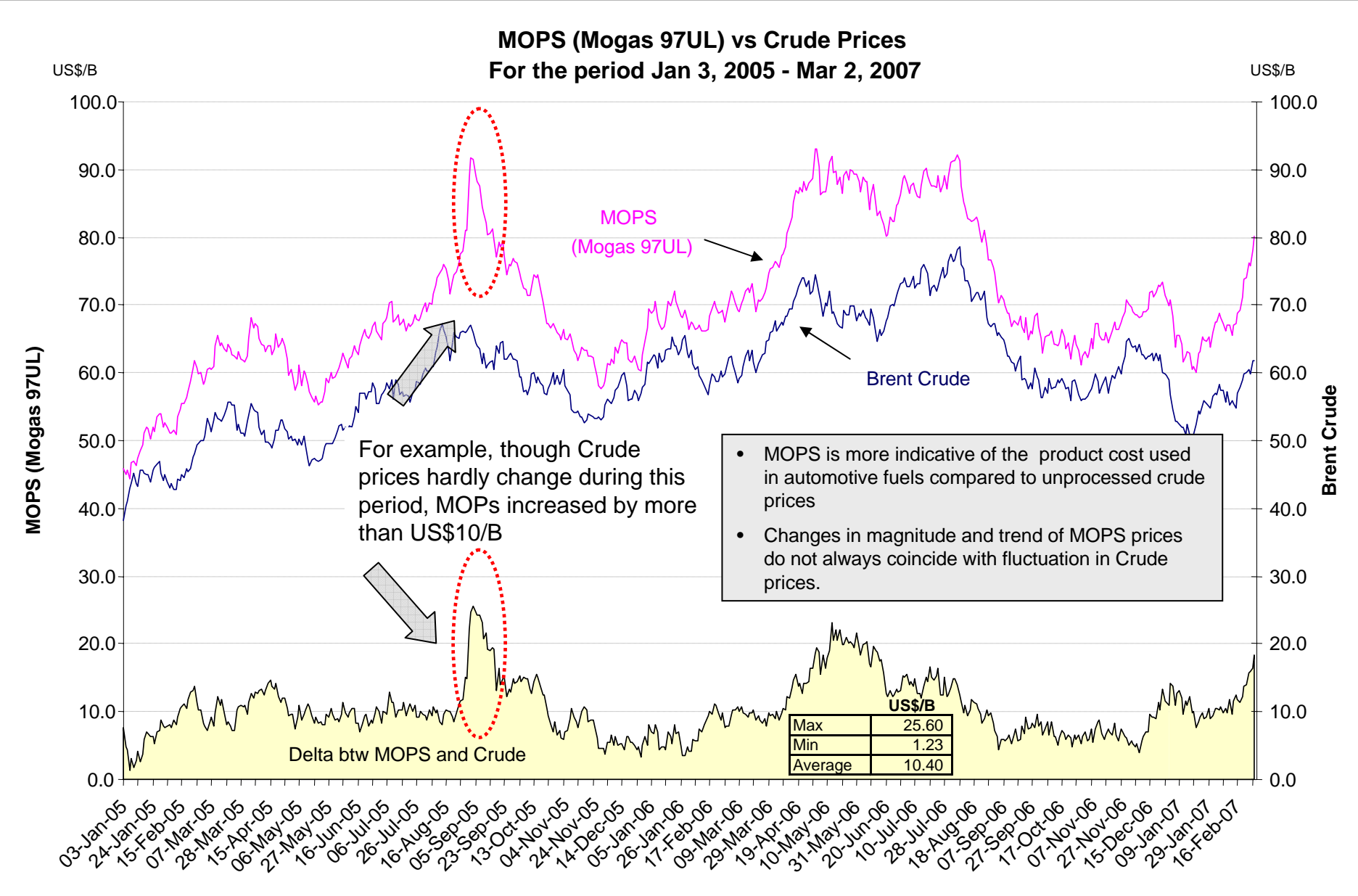


Chart 2 : EMHK Synergy 8000 Petrol Pump Price & Product Cost Trends

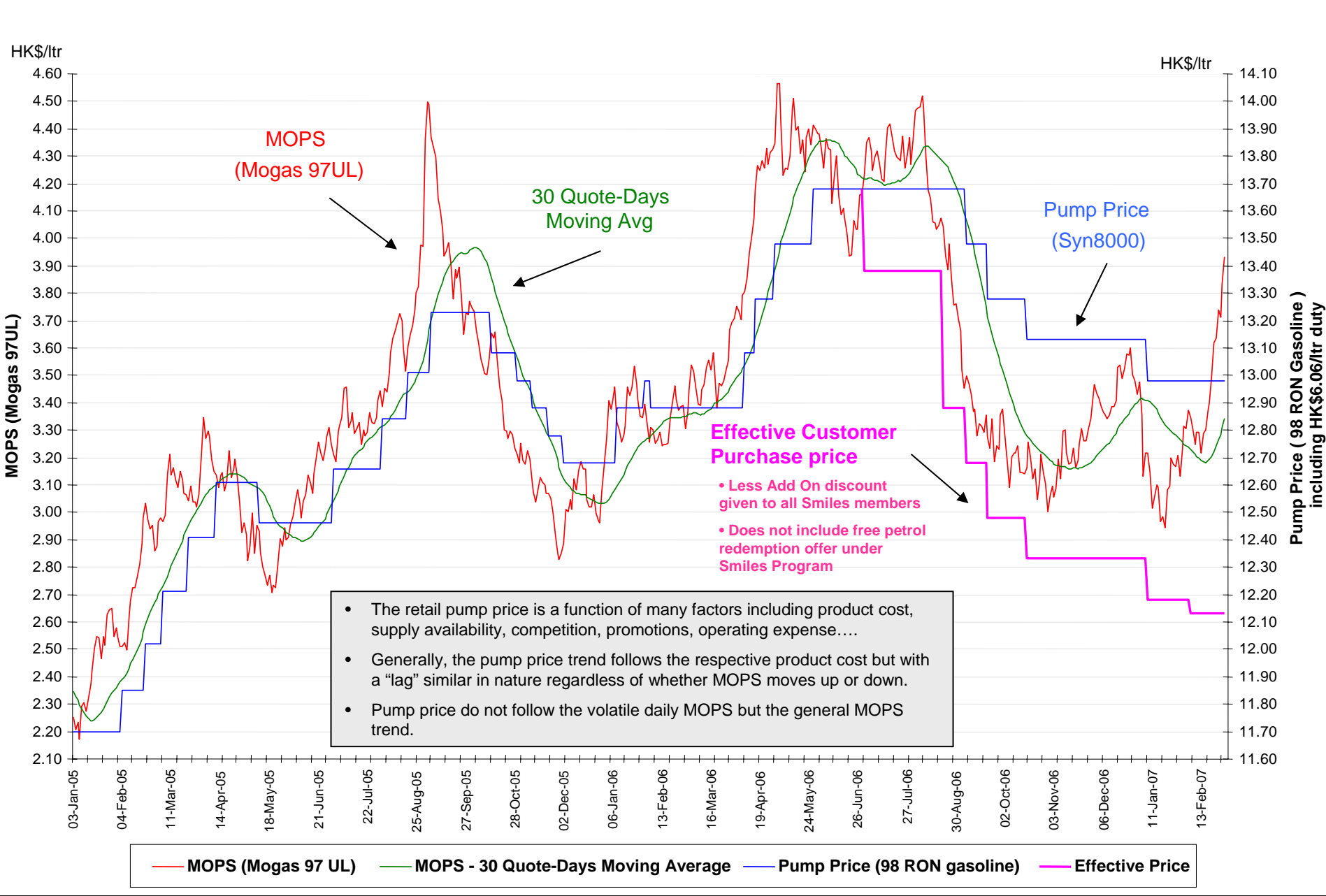


Chart 3 : EMHK Synergy Diesel Pump Price & Product Cost Trends

