

REPLACEMENT COST OF SALES OPERATING PROFIT BASIS OF ACCOUNTING

- To assist in understanding the Group's operating performance, the directors have provided additional disclosure of the Group's results for the year on a replacement cost of sales operating profit basis⁽ⁱ⁾, which excludes net inventory gains and losses.
- On a replacement cost of sales operating profit basis excluding significant items, the Group's net profit after income tax for the year was \$524 million, compared to a profit of \$628 million in 2015.
- 2016 net profit before interest, income tax and significant items on a replacement cost of sales operating profit basis was \$813 million, a decrease of \$164 million over 2015.

\$ Million	Five years*	2016	2015	2014	2013	2012
Historical cost operating profit before significant items, interest and income tax expense	3,420	936	783	279	798	624
Add/(deduct) inventory losses/(gains) ⁽ⁱⁱ⁾	473	(122)	193	516	(246)	132
Replacement cost of sales operating net profit before significant items, interest and income tax expense	3,893	813	977	795	551	756
Net borrowing costs	(426)	(73)	(77)	(91)	(89)	(97)
Historical cost income tax expense before significant items	(889)	(253)	(214)	(56)	(205)	(161)
Add/(deduct) tax effect of inventory gains/(losses)	(142)	37	(58)	(155)	74	(40)
Replacement cost of sales operating profit after income tax ⁽ⁱⁱⁱ⁾	2,436	524	628	493	332	458

* Note: Totals may not sum due to rounding.

⁽ⁱ⁾ The replacement cost of sales operating profit basis (RCOP) removes the unintended impact of inventory gains and losses, giving a truer reflection of underlying financial performance. Gains and losses in the value of inventory due to fluctuations in the USD price of crude oil and foreign exchange impacts constitute a major external influence on company profits. RCOP restates profit to remove these impacts. The Caltex RCOP methodology is consistent with the methods used by other refining and marketing companies for restatement of their financials.

As a general rule, an increase in crude prices on an Australian dollar basis will create an earnings gain for Caltex (but working capital requirements will also increase). Conversely, a drop in crude prices on an Australian dollar basis will create an earnings loss. This is a direct consequence of the first in first out (FIFO) costing process used by Caltex in adherence with accounting standards to produce the financial result on a historical cost basis. With Caltex holding approximately 45 to 60 days of inventory, revenues reflect current prices in Singapore whereas FIFO costings reflect costs some 45 to 60 days earlier. The timing differences creates these inventory gains and losses. To remove the unintended impact of this factor on earnings and to better reflect the underlying performance of the business, the RCOP NPAT methodology calculates the cost of goods sold on the basis of theoretical new purchases instead of actual costs from inventory. The cost of these theoretical new purchases is calculated as the average monthly cost of cargoes received during the month of those sales.

⁽ⁱⁱ⁾ Historical cost results include gross inventory gains or losses from the movement in crude oil prices. In 2016, the historical cost result includes \$122 million inventory gain (2015: \$193 million inventory loss). Net inventory loss is adjusted to reflect impact of revenue lags.

⁽ⁱⁱⁱ⁾ Replacement cost profit after income tax is calculated before taking into account any significant items over the five years. The total effect of these significant items in each year was: 2012: \$441 million expenses before tax (\$309 million after tax); 2013: \$28 million gain before tax (\$26 million after tax); 2014: \$160 million expenses before tax (\$112 million after tax); 2015: \$32 million gain before tax (\$29 million after tax); and 2016: no significant items were recognised.