

# Chairman's



# Statement

Dear Shareholders,

In this, my first statement as your new Chairman, I wish to thank all our stakeholders for your support. I am pleased to report that your Company continued to maintain profitability in 2006 despite the challenges of a volatile operating environment. Our ability to weather the year's setbacks is in no small part owing to the efforts of the dedicated team that continues to build upon your Company's proud culture of sustainable progress. I wish to thank the Board of Directors and Management for their invaluable support and continued commitment to driving your Company forward. Together, we are putting in place the plans to secure the future growth of your Company's business.

On behalf of your Board of Directors, I am pleased to present the Annual Report of Shell Refining Company (Federation of Malaya) Berhad for the year ended 31st December 2006.

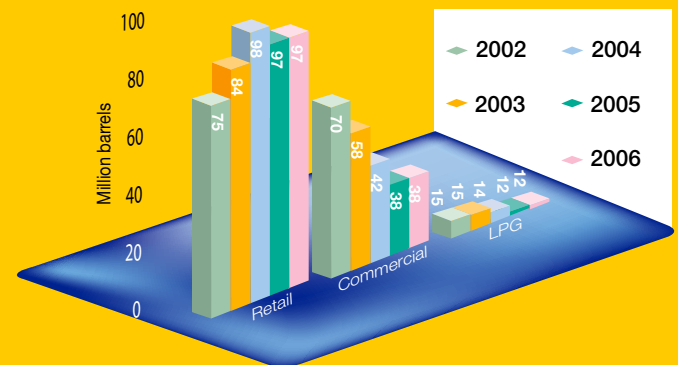
## BUSINESS ENVIRONMENT

In 2006, the world economy continued to expand despite high crude oil prices and monetary tightening in major economies. Economic activities in developed countries remained favourable, with the Euro arena improving on the back of positive consumer and business sentiments. Among developing economies, there was continued robust growth in China, India and other Asian nations supported by increased exports, investment and consumption.

The Malaysian economy too was stronger and more resilient in 2006 with the Central Bank of Malaysia (Bank Negara Malaysia) reporting that real gross domestic product (GDP) had expanded to 5.9% from 5.2% in 2005. Domestic activity, particularly in the private sector, and high export demand continued to propel economic expansion, while the public sector continued to provide a supportive environment to promote economic activity. Both domestic demand and private investment strengthened during the year, the latter spurred by significant capital outlays in the manufacturing, services and oil and gas sectors. Economic activity was also given a boost following the release of the much-awaited Ninth Malaysia Plan (9MP) in March 2006.

Overall, domestic demand for petroleum products was about the same in 2006 compared to 2005. Both sales of automotive gasoil and motor gasoline increased by 2% and 1% respectively in 2006. In the industrial sector, industrial gasoil sales increased by 2%. Aviation fuel decreased by 7% following a 7% increase in the previous year. LPG sales volume also registered a reduction of 1% compared with an 8% reduction in 2005.

Sales of Petroleum Products in Malaysia (million barrels)\*



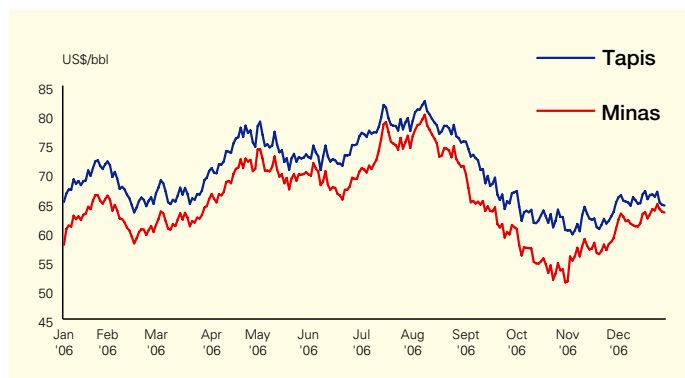
\* Source: ACNielsen Quarterly Petroleum Sales Report

Refining margins, which are essentially the difference between crude oil and refined product prices, came under increasing pressure in 2006 in comparison to the preceding year. Throughout 2006, local crude prices fluctuated between US\$59 to US\$82 per barrel (US\$40 to US\$61 in 2005). The movement of the product prices, measured by Means of Platts Singapore (MOPS), displayed a similar trend, with MOPS of U97 gasoline fluctuating between US\$61 to US\$93 per barrel (US\$44 to US\$91 per barrel in 2005). As a result of the higher crude oil prices relative to product prices, the average Singapore complex refining margin for 2006 was US\$2.95 vs US\$4.17 in 2005.

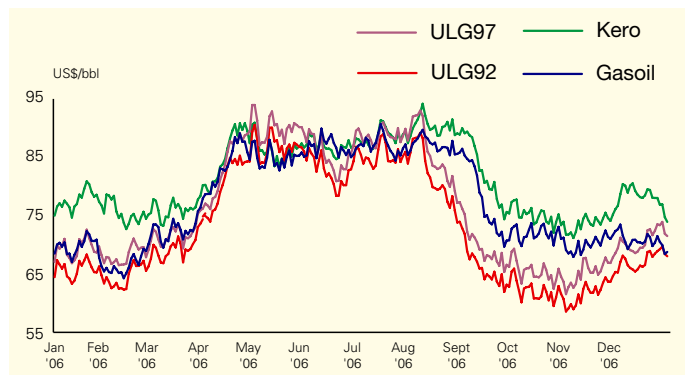
## Chairman's Statement

The more sophisticated complex refineries continued to reap rewards of their earlier investments as complex refining margins remained materially above margins realised by simple hydro-skimming facilities. Your Port Dickson refinery with its Long Residue Catalytic Cracker (or LRCC) configuration and its ability to capitalise on a variety of crude feeds was able to realise a higher margin than the average Singapore complex refining margins.

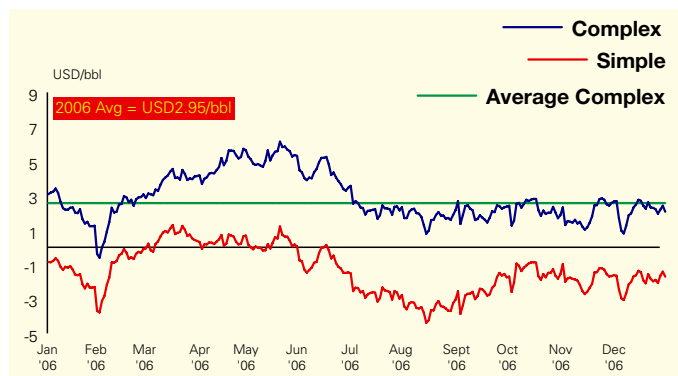
### Tapis / Minas



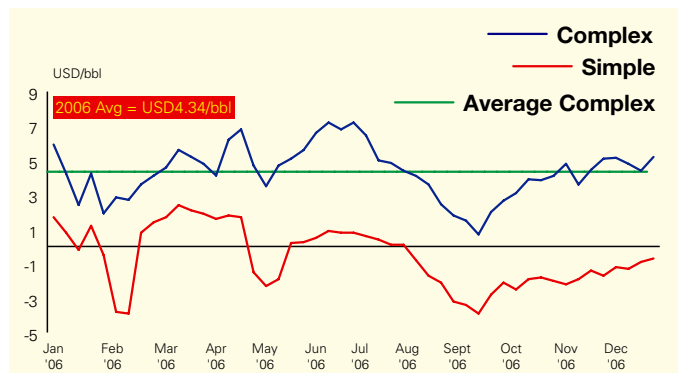
### Products Prices (MOPS)



### Singapore Refining Margin 2006



### SRC Refining Margin 2006



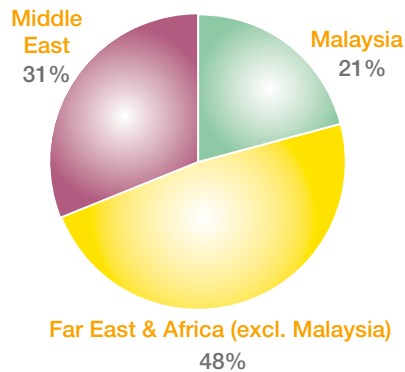
## PRODUCTION AND SALES RESULTS

In 2006, your Company's Port Dickson refinery achieved a record utilisation rate of 90.6 %, an increase from 76.2% in the previous year. There was no major statutory shutdown in 2006 compared to one undertaken in 2005. These regular and meticulously planned shutdown activities are aimed at maintaining and enhancing the long-term reliability and integrity of your Company's core processing assets.

Your Company typically processes between 29.0% to 31.0% Middle East heavy crudes, 37.0% to 48.0% Far East heavy crudes, and 21.0% to 34.0% Malaysian light crudes. The decision on which crude we procure depends on the relative economic attractiveness. The flexibility to vary the crude feedstock and product output is important for the Company. For the year under review, our crude diet consisted of 48.0% from the Far East and Africa (excluding Malaysia), 31.0% from the Middle East and 21.0% from Malaysia. In 2006, refinery intake appreciated to 39.6 million barrels from 36.4 million barrels in 2005.

## Chairman's Statement

**Crude and Feedstock Processed - Sources of Supply (2006)**



In total your Company successfully processed 17 types of crude oil thus further increasing our refinery's ability to take advantage of the relative economic attractiveness of different crudes – the LRCC continues to give us this flexibility.

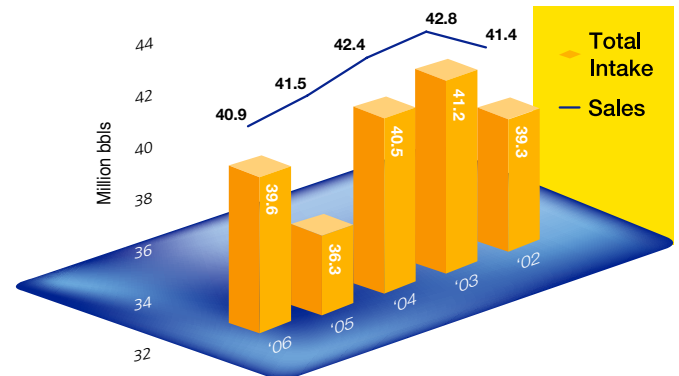
2006 saw a slight reduction in our sales volume to 40.9 million barrels from 41.5 million barrels in 2005. Nevertheless, sales proceeds appreciated by 12% to RM10,887 million in 2006 from RM9,695 million in 2005. I am delighted to report that this result, attributable to markedly higher product prices from March to August 2006, is the highest annual proceeds level in your Company's history.

Gasoil and motor gasoline continued to be the refinery's major products, forming 70.0% of our total production. The LRCC unit, in which your Company invested in the nineties, proved its value by giving us the opportunity to produce higher margin products – several products streams, e.g. polypropylene, enjoyed high price levels.

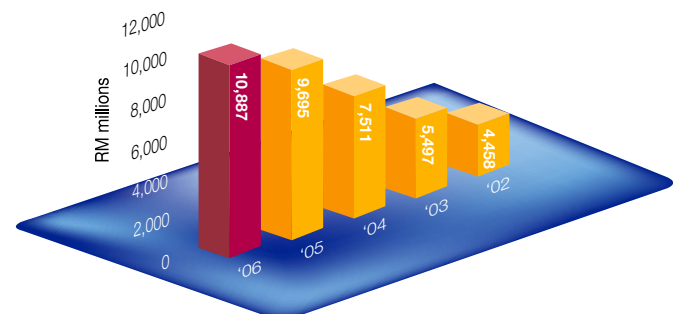
### FINANCIAL PERFORMANCE

For the year under review, your Company's performance was dictated by fluctuating refining margins and the movement in world oil prices. As a consequence, our after-tax net income in 2006 declined to RM258 million from RM522 million in 2005. The decline was attributable mainly to stockholding losses and lower refining margins. The pre-tax stockholding gain in 2006 was only RM40 million compared to RM210 million in 2005 as a result of lower differential in oil prices compared to 2005. Refining margins were lower in 2006 as product price increases did not commensurate with crude oil price increases.

**Shell Refining Company Refinery Intake and Sales (2002 - 2006)**



**Shell Refining Company Sales Proceeds**



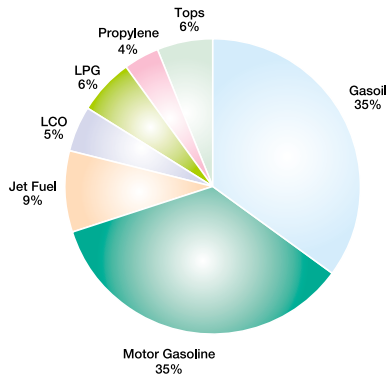
### EPS AND DIVIDENDS

As a result of the lower net income, for the year under review, our earnings per share (EPS) eased downwards to 85 sen from 174 sen in 2005.

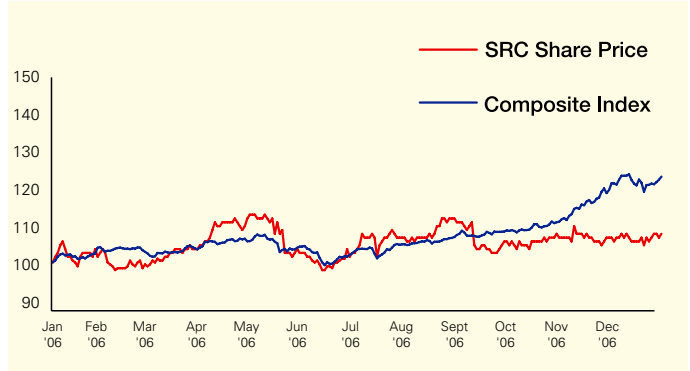
For the year ended 31st December 2006, your Board of Directors has recommended a final dividend of 38 sen per RM1 unit share for the year under review. Together with an interim dividend of 12 sen and two special interim dividends totalling 40 sen, this brings the total gross dividend payable for the financial year under review to 90 sen per share. The dividends payable in respect of 2006, represent the second highest dividend your Company has ever paid to date. Your Company's Board of Directors hopes that you are pleased that we continue to deliver on our enhanced dividend strategy as announced in November 2005.

## Chairman's Statement

Sales Turnover (By Product) 2006



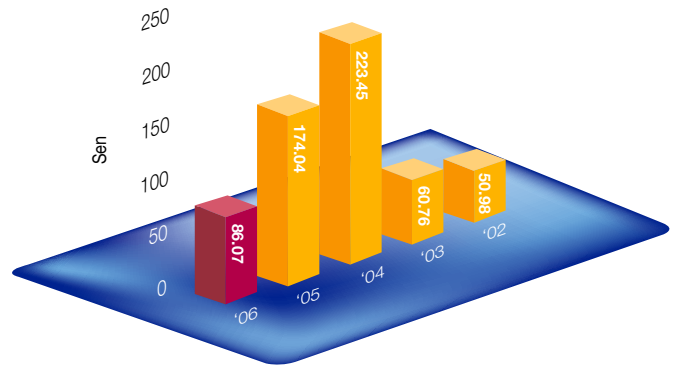
SRC Share Price vs Bursa Malaysia Composite Index (normalised)



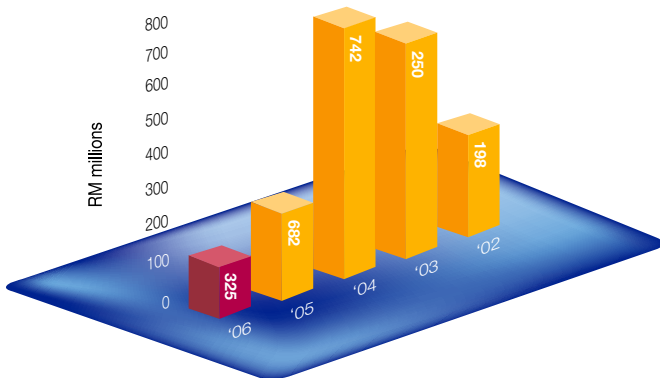
Your Board of Directors maintains its firm intention to sustain an annual dividend level of at least 50 sen per share (interim plus final) for the foreseeable future, excluding special interim dividends subject to financial performance and cash availability.

While developments related to your Company's share price for the year under review were acceptable, rest assured that your Board is acutely aware that we cannot rest on our laurels. Moving forward, your Company will work to implement further performance enhancing initiatives that we envisage will result in attractive profit levels and cash generation.

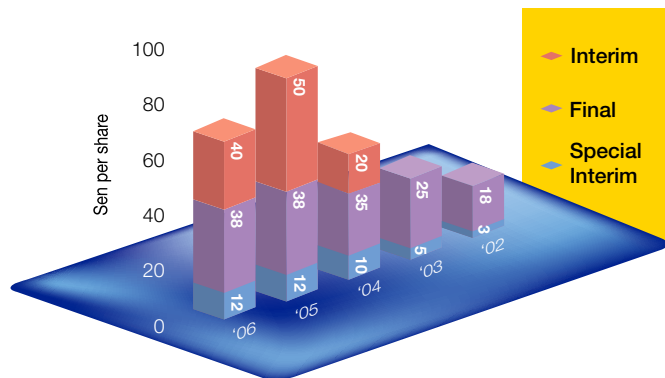
Shell Refinery Company Net Earnings per share



Shell Refining Company Profit Before Taxation



Shell Refinery Company Dividends per share



## Chairman's Statement



### BUSINESS STRATEGY AND IMPROVEMENT INITIATIVES

Your Company's success to a large extent continues to hinge on the successful implementation of a three-pronged business strategy that revolves around the core element of PEOPLE. These three strategies are:

- Productivity Improvement which aims to decrease the number of man-hours required to run the refinery in a highly efficient, safe and structured manner;
- Margin Uplift which involves continuous efforts to enhance margins and offset the impact of adverse market forces; and
- Cost Leadership which focuses on driving costs down efficiently without compromising on margins and the integrity and safety of the plant, our people and contractor staff.

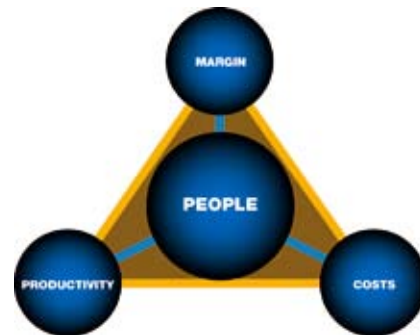
These three strategies and their related activities are part and parcel of our Business Plan and are firmly embedded in the annual business planning process.

Over the course of 2006, several Business Improvement (BI) activities were initiated in line with a global effort within Shell to seek out opportunities to enhance value capture within Shell's manufacturing business. The global BI initiatives form a natural adjunct to your Company's three-pronged business strategy and cover these five work-stream areas:

- Health, Safety, Security and Environment (HSSE)
- Organisational Effectiveness
- Operational Availability
- Margin & Energy
- Cost

As part of the global BI effort, a Business Improvement Review (BIR) is to be held every two years to generate new ideas for improving the work-stream areas. In addition, a quarterly review is to be carried out to check on the progress of these BI initiatives.

November 2006 saw your Company holding its first BIR with the assistance of consultants from Shell Global Solutions. 2006's BIR focused on the three areas of Organisational Effectiveness, Margin & Energy and Operational Availability to look at how efficiently the organisation is able to deliver key business objectives and improvement opportunities for margin enhancement, energy reduction and increased reliability of plant equipment.



## Chairman's Statement

### IN RECOGNITION OF BEST PRACTICES

In 2006, your Company continued to win various awards and accolades including two prestigious awards at the 2006 National Annual Corporate Report Awards (NACRA) event. The event saw us successfully retaining the "Best Annual Report in Environmental Reporting Award" for the fifth consecutive year and the "Industry Excellence Award" for the second consecutive year. The latter award is conferred on companies listed on Bursa Malaysia's Main Board under the Industrial Products and Technology sector. Your Company also received the "Best Environmental Reporting in an Annual Report" at the ACCA Malaysia Environmental and Social Reporting Awards (MESRA) 2005. These multiple wins demonstrate your Company's commitment and drive towards ensuring that a complete and informative performance report, including our environmental performance, is disclosed to shareholders and society.

2006 also saw your Company securing the "Best Practice Award" at the National Awards for Management Accounting Best Practice (NAFMA) for the third year in a row, and the Institut Kimia Malaysia (IKM) "Laboratory Excellence Award" for the fifth year running. In addition, your Company was also recognised for its exemplary HSSE performance by means of various external awards and certifications. For further information on your Company's achievements, please refer to subsequent sections of this annual report.

### SUSTAINABLE DEVELOPMENT INITIATIVES

In line with Shell's General Business Principles, that include complying with the Shell Group's Sustainable Development Management Framework, your Company subscribes to the principle of sustainable development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs. Our actions are directed by the need to make business decisions that give credence to our sense of economic, social and environmental responsibility and by which our stakeholders and society can hold us accountable.

Your Company is a key member of the Port Dickson community. Our contributions to the local community do not always take the form of direct funding and monetary sponsorships. We provide employment and business opportunities, and we invest in programmes and initiatives to raise the socio-economic status of Port Dickson and improve the locality's standard of living and quality of life. In 2006, we have organised, supported and participated in the following programmes namely 'Save Our Coral Beach Cleaning Campaign' with University students and National Service Trainees, English Language Debate, Drama and Public Speaking competitions with secondary school students, Community Dialogue with the neighbours, NGOs and government authorities, Joint Road Safety Campaign with NGOs, Lions Club, and Police Department, to name a few.

### PEOPLE DEVELOPMENT

Your Company deems people to be the most important asset. Indeed, our employees are our strength and we firmly believe in enabling employee training that enhances performance. Management thus has the responsibility for ensuring that our workforce is equipped with the relevant knowledge, skills and attitude so they can deliver to the best of their abilities.

Training that develops employee potential and enhances employee performance is central to the effective conduct of your Company's business. All employees' training is founded on clear, identified business needs and objectives based on job requirements. These are then pitched against performance criteria and conducted in a manner conducive to achieving organisational goals. In 2006 we spent a total of RM1.8 million on employees' training. This is an amount well spent to continuously afford our employees sufficient opportunities to bridge any technical competency gaps and help foster the forging of a strong team spirit and better interactions at all levels.

### BUSINESS OUTLOOK

Going forward, global economic expansion is expected to be sustained at above 4.0% in 2007 with major economies generally moving towards a moderating trend. While the broader US economy is expected to sustain its underlying growth despite some sectoral weakness, there will be more broad-based global growth in line with the recovery of Japan's economy as well as improved growth prospects in the Euro arena and sustained growth in the Asian region.

## Chairman's Statement



Bank Negara Malaysia predicts that the Malaysian economy will maintain a steady growth path in 2007 with a 6.0% GDP growth rate. Domestic demand from both private sector and public sector activity is expected to support the growth momentum of the Malaysian economy. Solid support for domestic growth is expected to come from sustained private consumption, continued expansion in investment activity and the implementation of 9MP projects.

Product demand is therefore expected to be robust and refining margins are expected to remain positive. However the level of these margins remain uncertain. Concerns over crude oil availability, volatility in oil producing areas, and heightened geopolitical tensions, are expected to linger. If product prices do not move in tandem with crude oil prices, refining margins will come under pressure.

### GOING FORWARD

No matter how the market scenario plays out, your Company is committed to maintaining our competitive edge through aggressive cost reduction and margin improvement initiatives, which hopefully will mitigate any weakness in refining margins. We will continue to realign our business strategies to meet changing market needs and will focus our resources and energies on meeting our business goals. People, health, safety, security, environmental issues, and asset integrity will continue to be major priorities.

### IN APPRECIATION

On behalf of the Company, my sincere appreciation goes to our shareholders, the Board of Directors, the Management, our employees, contractors and all our other stakeholders for your loyalty, perseverance, dedication and effort in the face of an ever evolving and challenging business environment. I trust that you will all continue to give us your support. On our part, rest assured that we remain committed to pursuing all opportunities with a view to maintaining your Company's growth and profitability as well as enhancing shareholders' value. We look forward to your continuing support as we endeavour to take your Company to new heights of success.

On a final note, I would like to take this opportunity to pay tribute to a fellow Director who will be leaving your Board. Dato' (Dr) Yahya Ismail, our Senior Independent Non-executive Director, will be retiring this year after serving your Company continuously since 19 September 1978. Dato' (Dr) Yahya's guidance for the last 29 years has been invaluable to the success of your Company and as the Senior Independent Non-executive Director, he has been a trusted confidant to all stakeholders.

Thank you.

A handwritten signature in black ink that reads "Saw Choo Boon".

**Saw Choo Boon**  
Chairman