Testimony of Bill Cline, Gaffney Cline & Associates.

Good morning, ladies and gentlemen, Senate President Neville James, and the honorable members of the 31st legislature.

My name is Bill Cline, I am the Senior Advisor with Gaffney Cline & Associates. Gaffney Cline was engaged by the Government of the US Virgin Islands to provide technical and commercial analysis support to the Government's negotiating team in respect of the potential sale and change of control of the St Croix refinery.

Gaffney Cline & Associates is an international consulting firm that specializes in the oil and gas sector. The firm was founded in 1962 and has approximately 180 people based in offices in the US, the UK, Latin America, Asia Pacific and the Middle East.

We cover all aspects of the oil and gas business from the far upstream (exploration and production activities) through the "midstream" (storage and transportation) and downstream (refining and marketing). Accordingly, our professional staffing comprises petroleum engineers, geoscientists, facilities and chemical engineers as well as economists and commercial experts. The average level of experience on our professional staff is in excess of 20 years and more than 10 years experience with Gaffney Cline.

Our clients include a very wide range of oil and gas companies from the very largest integrated "major" oil companies through to the smaller independent oil and and gas companies. We also have a significant business in providing technical support to the financial institutions, particularly in respect of project financings, collateralized loans, acquisition due diligence and stock market issues.

About 50% of our business worldwide is what we refer to as our "sovereign" practice. These include national oil companies, ministries of energy and finance. Our work for this sector include technical analyses as well as the development of business and contractual frameworks to link "public" resources (such as oil and gas rights or properties that are held by Governments or State-owned entities) with technology and capital from the private sector.

In this area our clients have literally run the gamut from A to Z and include entities that range from very well known oil and gas producing countries like Saudi Arabia, Kuwait, Iraq and the State of Alaska to others with less well established oil and gas interests like Timor Leste, Chile and Greenland. Here in the Caribbean we have a very long history of working for the Government of Trinidad and Tobago and some years helped Aruba negotiate the exit of its refinery operator.

For my part, I am an economist. I have 35 years of experience in the oil and gas sector much of it providing advice to these "sovereign" clients and providing valuations of oil and gas assets and properties for transactional or dispute resolution purposes.

Now to the work and analysis we undertook for the Government of the US Virgin Islands in respect of the St Croix facility we see pictured here.

Gaffney Cline was engaged by the Government to provide technical and commercial support throughout the process of negotiations and bidding for the sale of Hovensa's storage terminal on St Croix.

Gaffney Cline's evaluation was based on information available in the public domain supplemented by our general industry knowledge and large network of intelligence and contacts in the industry. We also received certain basic information from counsel to the USVI (in terms of tanks, capacities, etc.)

Importantly, Gaffney Cline's analysis *excludes* consideration of the potential use, restart in full or in part, or disposition of the refinery (including all costs and liabilities associated with any decommissioning undertaken and associated site cleanup and restoration).

The analysis also *excludes* consideration of the housing and land associated with the facility being transferred.

Also, the analysis critically assumes that the acquirer is granted exemption from income taxes for the duration of the contract period.

We analyzed both the Arclight and Buckeye bids over the course of the process and carried our evaluation of the terminal based upon a reconciliation of:

- First, a "comparable sales" approach based on both the sales of similar assets and the cost of adding capacity. This approach also includes the price at which similar assets trade in the public markets; and

- Second, a "discounted cash flow" approach reflecting the present value of estimated future earnings of the assets. This approach basically forecasts the future cash flows both incoming revenues and outgoing costs and expenses of the facility and discounts those cash flows back to the current date to arrive at a "present value".

Both of these approaches are routinely used in the valuation of assets and companies in all industries, not just those relating to petroleum-related assets and are universally accepted as reliable methods for valuation.

The acquisition of assets by Master Limited Partnerships or "MLPs" in the US is normally viewed in terms of a multiple of EBITDA (Earnings Before Interest, Taxes and Depreciation and Amortization). For example, Buckeye, who was one of the bidders in this transaction is a publicly traded limited partnership that at the end of October was valued in the market for approximately $9 billion. This valuation is approximately 10.7 times its $900MM adjusted EBITDA

A September report prepared by Wells Fargo showed a multiple for storage-based enterprises in the US in the range of 7.7 to 11.6.

In this table you can see the date of the transaction in the first column, a description of the asset and then the consideration or purchase price in millions of US dollars. The EBITDA is shown in the second column from the right and the "multiple" is derived from the arithmetic relationship between the purchase price or value and the level of earnings or EBITDA.

It is Gaffney Cline's view that a range of 7 to 10 times EBITDA would be a reasonable basis for the value of the St Croix terminal. While this is a relatively tight range it should be noted that other considerations will also weigh on the multiple, such as the cost to dismantle and remediate the refinery, as well as possible higher costs associated with operating in the Virgin Islands, in particular the relatively high cost of power.

While we have lots of examples and transactions from the US in terms of EBITDA multiples, examples from the Caribbean market are much scarcer and less complete. This table shows a much sparser data set and a much wider range of implied values. Ranging from $80/barrel in BORCO and on the order of $30 /barrel for St Lucia. By way of comparison, this transaction is also on the order of $30 per barrel.

In addition we also looked at the cost of adding storage terminal capacity in the Caribbean market. In reviewing the information on the other Caribbean terminals only BORCO in the Bahamas seems to have the physical space for expansion. The rest of them are constrained by physical limitations and topography unsuitable for construction of storage tanks.

At BORCO, Buckeye invested $ 380 million to increase capacity by 7.5 million barrels. This works out to $ 50.7 per barrel. Buckeye also indicated that such investment would produce a $ 70 million to $80 million EBITDA increment to BORCO. Using the same per barrel metric, we estimate that an expansion of 13 MMBbl would cost on the order of $ 660 million.

So the acquisition of 13 million barrels of storage at a cost below this level represents a reasonable opportunity for a terminal operator considering expansion. Of course it will be appreciated that there will be certain differences in operating costs as well as incremental expenditures which may be required to bring the 13 million barrels of capacity back into service.

The following slide summarizes the key commercial terms of the operating agreement agreed with Arclight, or more accurately, the Limetree Bay Terminals, LLC on December 1.

The agreement has a 25 year term with a 15 year extension. The buyer will make closing payments of $370 MM in total . $235 MM goes to the USVI and $135 MM to Hovensa/the Creditors Committee. Since this latter payment does not go to the Government it has been excluded from our economic evaluation

In addition to this upfront payment, there will also be a variable annual payment to the Government during each year of the facility's operation. The variable payment will be 9% of Terminal Revenues where Terminal Revenues are less than $120 million in the applicable year. When Terminal Revenues exceed $120 MM the payment will be 10% of Terminal Revenues. I would note that these apply just to the storage and terminal revenues. However, if the refinery were to be restarted in whole or in part the Government would be entitled to 17.5% of Refinery EBITDA. This provides some substantial commercial protection to the Government in the circumstance that somehow the refinery is re-started.

Regardless of the revenues of the facility, the Government will be entitled in any event to a minimum annual payment of $4 million in year 1, rising to $5 million in year 2, $6 million in year 3 and $7 million in year 4 and each year thereafter. In addition, the agreement also has what would normally be described as a 10% "Carried interest". By this I mean that the Government has the economic benefit *as if* it was a 10% partner in the facility but did not have to pay for its share of capital investments. A payment for this is triggered in the event there is a change of control in the Terminals' ownership. In that case the Government would receive 10% of the Total Realized Profit upon such change of control. For the purposes of the agreement, "Total Realized Profit" means Terminal Operator's total Distributions plus consideration received by the Equity Holders, less all capital contributions to Terminal Operator. In any event the minimum payment to the Government in such circumstance would be $25.5 million.

Gaffney Cline looked at a number of cases but settled on 2 basic scenarios. Both contemplate getting to 31 million barrels of capacity by year 5. One considers the agreement runs the full 25 year term while the other assumes that there is a change of control in Year 10 and that the transaction is consummated in the range of 6 to 10 times EBITDA, but that the terminal continues operations.

In terms of the underlying assumptions on revenues and costs, Gaffney Cline reviewed revenue projections and cost information presented to the Government by both Buckeye and Arclight. We supplemented that information through industry contacts and intelligence. As a result, our analysis was based on an average $0.50 per barrel per month storage fee. It will be appreciated that storage fee levels can change dramatically depending on market conditions - in particular the shape of the "futures" market. Basically when the price for oil to be delivered in the future is higher than it is in the present (the traders call this a "contango" market), the value for storage is higher as one can sell the crude for delivery in the future at a higher prices than it can sell a barrel today. Of course to do that one has to have a place to store the crude awaiting the delivery date. Conversely when future prices are lower than current prices (as they were when crude oil was selling for in excess of $100 per barrel, the value of storage is lower. We are currently in a very strong contango market – i.e. the value of storage is in the "high" range of the cycle.

We corroborated our views on operating costs and storage pricing assumptions with public information and our internal industry experts. I would note that any revenue from refinery operations (variable refinery payment) and ancillary services is *excluded* in the current analysis.

As I mentioned earlier, we have assumed Terminal Operations start with an available base capacity of 13 million barrels and then expands to 31 million barrels total capacity by year 5 as a result of investment of $505 million.

Once at full capacity, we expect that the St Croix facility will operate with an operating expense of $ 55 million per year and generate annual revenues of $ 186 million, leading to an expected annual EBITDA on the order of $ 131 million with an annual payment of $ 18.6 million to USVI

The following table shows the result of our Discounted Cash Flow analysis. What I show here in the second column is the 31 million barrel expansion for the full 25 year term. This results in total cash flow over the period to the Government of $673 million. Of which $235 million is upfront and $433 million is in subsequent annual payments which at their peak are $18.6 million per year. In this scenario there is no change of control and therefore no additional payment for the 10% share of total realized profit.

In terms of present value, the last 2 rows show the value of those cashflows discounted at 5% and at 10%. I would expect that the Government will be assessing present value within that range, probably closer to the 5% than the 10%. So you can see there that this points to a value to the Government from the transction on the order of $383 to $474 million.

The last 3 columns shows the same analysis except it assumes a change of control transaction in year 10 and 3 different "price" levels for that change of control transaction in terms of EBITDA multiple. If I just focus on the midpoint of the EBITDA trading range (8 times) the value is in the range of $423-540 million.

Overall we consider the expansion to 31 Million barrels to be highly probable and likely to be pursued aggressively, given Arclight's partner Sinopec's significant trading of Venezuela's and other countries' heavy crude oils.

Indeed, Sinopec's involvement in Gaffney Cline's view significantly increases the chances of the refinery being re-started on either a full or partial basis given Sinopec's interest in extra heavy oil projects in Venezuela's Orinoco Heavy Oil Belt and the difficulties of building new upgraders in Venezuela (an upgrader is basically a refinery that "upgrades" otherwise difficult to transport and market crudes into some thing that can be processed at a traditional refinery).

This graph shows a basic range of potential annual payments to the Government (this is measured on the "Y" or vertical axis) and how it differs according to the level of storage fees (these range from $0.30 to $1.00 per barrel per month on the "X" or horizontal axis.) and as a function of the level of utilization of the facility. The graph shows utilization levels ranging between 60-100% (these are represented by the small symbols which basically slope upwards from left to right). In any event the minimum annual payment of $7 million to the Government will apply.

In summary this chart shows that the Annual Payment can range between $7 to $37 MM under various price, capacity and utilization assumptions.

In terms of sensitivities and in round numbers:

- Every $0.10 change in storage rate is equivalent to US$3.7 MM in annual payment to USVI
- Every 1 MMBbl storage capacity is equivalent to US$0.3 to 1.2 MM in annual payment to USVI
- Every 10% change in utilization rate is equivalent to US$1.9 MM in annual payment to USVI

This chart shows a diagram of the annual cash flows to the Government. The yellow bars chart up the gradual increase of the variable annual payments from $4million in year 1 to $7mm in year 4 and beyond. We can also see the $235 million up front payment and the $113 million share of realized profit upon a change of control in year 10.

This next chart shows a diagram of the annual cash flows for the whole project. Unlike the Government's cash flows which are always positive and have a minimum. This chart shows (in purple) the cash outflows that Arclight will incur associated with the upfront payment and the approximately $500 million in capital costs estimated for the expansion to 31 million barrels of storage capacity.

Let me now wrap up with a few concluding comments.

First, we were asked by the Government to give our opinion on what would be the equivalent tax rate for this business. In other words, if we treated all of the upfront payment, the variable annual payments and the 10% carried interest as income tax and we considered the likely expenses, capital depreciation and other deductions that would be used to offset against taxable income. We consider Arclight's offer to be equivalent to an effective corporate income tax rate on the order of 30-35% *__and__* it provides an opportunity for USVI to collect this tax upfront immediately after the transaction.

The proposed structure provides a stable annual payment of at least $7 million per year, regardless of profitability status of the facility.

Obviously there will be benefits in the Territory from expanded employment, ancillary services and lower cost fuel to the islands. There are also what economists would call "multiplier" and "Spillover" effects though quantification of these was beyond the scope of the analysis we undertook.

The agreement structure also allows the Government to share in any upsides of the St Croix facility in cases of additional revenues/operations including even possibility of the return of refinery operations The structure of the transaction (i.e. the payments are based on revenues and not on income) and the nature of the buyer suggests that the arrangement cannot easily "gamed" by costs inflation or capacity utilization and /or transfer pricing issues.

I would conclude by observing that the limited expansion potential at other Caribbean facilities makes the St Croix facility a viable opportunity for investors (though the facility is currently constrained by vessel draft limitations and operating cost considerations). As I mentioned earlier, the current market is very strong but it is volatile and highly sensitive to the shape of oil price "futures". Clearly the current market conditions will not last forever and storage rates and utilization rates will certainly fluctuate in the years ahead. In our view, this is an excellent timing for the transaction from the Government's perspective and the nature of the payments and sharing of "upside" comprise a structure that should assure the Government of full and fair compensation.