SARAS

Third Quarter 2010 Results

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Welcome

Massimo Vacca

Head of Investor Relations

Ladies and gentlemen, good afternoon, and thank you for joining us today for this conference call on SARAS's Third Quarter Results. Today we have the usual agenda: we will start with Mr Dario Scaffardi, General Manager, who will give an overview on company results and he will discuss the highlights of the period. We will then move to Mr Corrado Costanzo, Chief Financial Officer, who will provide a detailed review of the results for each business segment and subsequently will discuss the group financials. Afterwards, back to Mr Scaffardi for the market outlook and the group strategy, and finally we will take your questions. Dario, please.

2010 Overview

Dario Scaffardi

General Manager, SARAS

I. Highlights

Thank you Massimo. Good afternoon, ladies and gentlemen, and thank you very much for joining us for our quarterly results. The refining environment in this quarter has still been extremely challenging. The benchmark – the EMC benchmark – was at minus 0.2, the second lowest historical level that we've seen since the inception of this benchmark and we've seen some signs of improvement only towards the end of the quarter; July and August have been extremely low in terms of margin.

In terms of operation our refinery has performed well, we've had smooth operations throughout the quarter and our efficiency programme which we have explained to you in the previous quarters has kicked into full mode in this quarter. We've had the first six months of the year in which we basically designed and analysed the areas that needed to be addressed and reorganisation of the company and the reorganisation in terms of work and job descriptions has fully started during this quarter and we are already starting to see some results, right after the summer we started seeing some very positive results of this work.

Overall the scenario still looks difficult for refining, but we see some signs that show a potential for improvement in the future. The most encouraging sign, in my opinion, is that of global demand. In September, global demand has been 86.9 million barrels, compared to 85.3 in the same month last year. If this sort of trend continues – and this sort of trend is mainly driven by diesel demand – then our refinery is fully equipped to take full advantage of increased diesel demand but even more so of increased conversion spread, which basically breaks down to the differential or to the ratio between the price of diesel and the price of fuel oil, and I believe that we can see this conversion spread improving in the future, albeit with base refinery margins still compressed.

Looking at the main points of our results, which Corrado will explain, I would like to point out that our debt is absolutely under control and shows no sign of increasing compared to that of the first half of this year. This is notwithstanding the fact that of course there is increased demand in working capital due to the fact that the absolute prices of oil have gone up and another important issue to point out is that our power and marketing segments have shown positive results and are helping the refining sector.

Market Overview

1. Diesel and Gasoline Crack Spreads

If we look at the next slides, the cracks of diesel and gasoline have been disappointing as are obvious from the graphs. We've seen a very modest gasoline season in the US and then it was basically expected. Also the diesel cracks have been under pressure although there are some important signs of improvement or potential improvement, one of the most important is the fact that Turkey – which is a huge consumer of diesel in the Mediterranean basin – will switch to full ULSD European type specifications at the beginning of next year. So we expect some increase in demand for high-quality diesel.

2. Refining and Power Margin

If we look at our refining and power margin, I would like to remind everyone that we have always put together power and refining, because, in our industrial complex, these two areas are absolutely linked together and one cannot exist without the other. This is the reason why we associate refinery margins with the power margins and we actually present in this graph the power margin as divided by actual refinery runs.

One thing that is important to point out is that we actively pursue a stabilisation of the refinery margin and the market that has been, over the past year and a half, in a very steep contango mode with the forward prices higher than prompt prices, give opportunities if you buy prompt crude and sell forward – providence basically, and this is what we do also to try to stabilise our margin, and the actual margin that we are able to obtain is much better than the potential spot margin, which is measured on spot prices. We look to average out monthly prices basically and Corrado will give much more detail on what we actually do, but through futures and derivative entrants we pursue this stabilisation and also we try to extract – in the same way that other players of the market try to extract – value from the structure of the market. This structure of the market, of course, with steep contango, tends to depress more than actual market conditions would warrant current refinery margins. There is a big incentive to transport diesel, so, basically, the actual margin that we are able to achieve is better than what we present at EBITDA level because there are earnings from these type of operations which Corrado will explain, and, at this point I would like to hand over to Corrado who will be able to give you much more detail.

Corrado Costanzo

CFO, SARAS

I. Segment Reviews

1. Refining

Thank you, Dario. Well, in fact, from certain points of view this was a rather uneventful quarter. In general operations were run smoothly through the quarter, in particular the refinery basically ran at full capacity except for minor run cuts at the beginning of the quarter and therefore runs were significantly higher than in the same period last year. Clearly margins were still disappointing. However, as Dario was saying, not everything happens at EBITDA level: there are transactions which at this point belong to the number of tools that we can use structurally to run our business where these transactions are, namely derivative transactions on oil products and crude oil, and we use them in a totally non-speculative way. We tend to smoothen and try and obtain averages for both sale process and purchase prices and to profit and to lock in margins which are available on markets from contango situations. Also, on foreign exchanges, we take conservative approaches and try and lock in margins as well. So, from time to time, we have been entering in these transactions for quite some time – years effectively, but the bottom line for the net gains or losses was never particularly significant. In the last few quarters – in particular Q3 – we're instead talking about significant numbers, especially in light of the disappointing margins which are available on the market and so no less than €16m actually have been accounted for on a different line item below EBITDA level which is, considering the EBITDA figure of minus 34, roughly, an important figure. I mean, basically, we cut the negative results in half.

So if we were – as we sometimes do – to look at these transactions exactly in the way that I'm describing now, we do look at those transactions internally in that way, and if we include these results we would be talking about a couple of dollars per barrel of margin and more or less premium on top of the EMC benchmark instead of about one dollar.

Moving on to the crude slate in Q3, we are back to satisfactory levels on crude slate of 53.3%, which clearly shows that operations were running smoothly.

2. Fixed & Variable Costs

Also costs are absolutely in line. Variable costs in terms of dollars per barrel more or less always around the same figures $2.2, $2.3 per barrel and fixed costs also absolutely in line with our year-end guidance of approximately €220m.

II. Power Generation

Let’s move on to the power generation. The Sarlux power plant also performed very well during the quarter. IFRS results are influenced by higher production of steam and hydrogen, which is the only non-equalised income. If we look at the Italian GAAP EBITDA, well, last quarter, too, we have seen a one-off truer payment relative to the CIP/6 tariff, so, actually, the figure for Q3, 33.8, is the more structural figure when things go well as they did in Q3. Financial results were also underpinned by a rise in the power tariff, now at 9.8 Euro cents per kilowatt-hour. You will probably remember that this power plant is quite strongly linked to crude oil prices and with a nine-month delay.

Fixed and variable costs

Fixed and variable costs for the Sarlux power plant are absolutely under control and in line too.

III. Marketing

Marketing: clearly overall demand was still relatively weak both in Spain and Italy. However, we posted strong volumes in Italy and in particular in Sardinia. We started selling directly throughout Sardinia some time ago, and we are growing rapidly and with very good margins there, so the bulk of the performance really comes from Italy and in particular from Sardinia. The absolute number €6.7m EBITDA was unfortunately negatively influenced by a €2.5m loss at biodiesel level. Biodiesel clearly is suffering quite a choppy market, so sometimes we make money and sometimes we lose money.

IV. Wind

Wind: well, looking at wind on a quarterly basis is not easy. There's clearly a lot of seasonality and the third quarter is usually the least profitable. Anyway, the results are broadly in line with last year’s on a nine-month basis. As a combination of two factors which, however, are slightly different: better production this year compared to last year, nine months again and slightly lower prices and both for power and green certificates, but the bottom line is roughly the same. During Q3, we have also completed the Ulassai Wind Park, which now has 96 megawatts fully installed and ready to go. We're not, however, running the full capacity yet. Dario will be more specific during his review of future developments.

V. Financial Overview

1. Key Income Statement Figures

A few words on CAPEX: very small amount of CAPEX during Q3, €20m ,of which about €13m were spent at the Sarroch Refinery, so there is the slow down in the pace of our investment plan which was masterminded over a year ago. It’s now in full force and effect, clearly we want to be in sync with markets here and certainly we're well positioned anyway the way we are.

2. Key Cashflow Figures

Looking at cashflow, cashflow was – I mean, debt before cashflow – the net financial position worsened by about €70m this is a number which is totally in line with the movements that can be generated by working capital needs on a quarterly basis you might see the reversal of that the next quarter; I mean plus or minus 50 to 100 really does not mean that there's a definite trend, on the contrary, we believe that, in spite of the very difficult moment for refining, we have, with the help of the other divisions, a balanced cashflow at a consolidated level.

Then to changes in our financing structure we have closed a very old project finance transaction which was still on the books of Sarlux – which, by the way, took an €18m hit at below EBITDA level, a one-off €18m hit. We had to expend in one quarter an amount which was being amortised and was related to fees which were paid for a number of reasons at the inception of the project finance transaction. So when we closed the project finance, we also took this hit. No cashflow linked to that; on the contrary, we're going to be benefiting from a tax point of view. I'm sorry I didn’t mention that when I was discussing Sarlux.

Then on the other hand we have issued €250m worth of Eurobonds with a five year bullet maturity. So overall we have also strengthened the structure of our funding, longer maturity than before and higher percentage of long term debt. So we feel very, very confident from that standpoint also. Dario, a look to the future.

Outlook and Strategy

Dario Scaffardi

I. Outlook

1. Refining & Power - 2010 Maintenance Schedule

Thank you, Corrado. As usual, looking at our maintenance schedule for 2010, we have completed all major maintenance as programmed. Instead, in 2011, we are publishing this quarter our scheduled maintenance chart. This is lighter from the refinery point of view than the maintenance carried out in 2010. We actually don’t have any major works in the refinery during the year apart from the usual and standard slow downs for cleaning of certain units and for the changing of catalysts in certain other units. There are no major works really planned and the impact in terms of refinery runs is modest as reported in the table and the terms in loss of EBITDA due to lower commercial capacity is something which is in the range of between $10 and $20m. Instead in terms of our IGCC power plant this coming year will have an important turnaround. It has reached ten years in operation so our maintenance contracts with the providers of the hardware specify a major overhaul. That does not imply any significant or very significant works in terms of CAPEX, but it does imply an extended period of shutdown because all the units will need to be opened and checked and controlled and cleaned to see what actions it might be necessary to perform.

In our accounts this will have basically no effect, because, as Corrado has explained, often all effects of the IGCC plant are linearized over a 20 year period, so this fact has already been taken into account, and so, in terms of IFRS results, you will have really no impact. The impact will be on Italian GAAP in terms of cashflow.

2. Oil Products Global Demand - Short term View (2010)

Looking at the market, as I mentioned at the beginning of this call, I personally see signs for improvement. The single most important factor is world consumption, particularly for an asset like SARAS which bases its profitability on the spread between fuel oil and gasoil. This spread has been under pressure for the last couple of years but for the wrong reasons. Basically we've had a relatively strong fuel oil because overall world demand has gone down and fuel oil production –

excuse me, fuel oil demand – has tended to be relatively stable. So there has been a relatively high demand for fuel oil. As soon as the world economy starts picking up again and we see definite signs of that, followed by oil demand, the demand is all for light product, so I would expect – and I'm fairly confident of this – that we will see the spread between the diesel and fuel oil start to widen, thus improving the economics of high conversion refineries. So I expect that we will see some definite signs of improvement, although the absolute level of crack spreads in terms of gasoline or diesel will probably remain under pressure while the profitability of a refinery such as SARAS will improve.

II. Strategy

1. Strategy Highlights and Implementation

In terms of our strategy, we have no major changes. We expect to give some guidance to the market probably at the beginning of next year on our updated investment plan and plans for the next three years. We are concentrating fully at the moment on obtaining the maximum efficiency from our industrial unit with this programme, which we call focus, and which is showing some very, very definite signs of improvement and which we are absolutely confident will be able to produce interesting results also directly on our numbers which is of course the important thing.

In the wind segment, one important thing to mention that Corrado said is that we have completed the upgrade of our Ulassai Wind Park, which has now installed 96 megawatts of power capacity. We are still in the process of obtaining full authorisation to enable us to provide up to 96 megawatts to the grid, but these new aero generators – of which there are six – are not idle, of course, and they in any case help to produce more power when we are not using, as is the case in general, the plant to its maximum installed capacity, which happens only in periods when you have a very high wind factor. In all the periods in which you have a lower wind factor, having more installed capacity is, of course, helpful in order that we can produce more power still capped at the official rate. We hope that we will, in the next couple of months – by the end of the year – be able to resolve this matter and to sell the full capacity to the grid.

As for our other activities, we are continuing as already explained before, so I will not say anything further. We will be pleased to take any questions you might have now. Thank you.

Questions and Answers

James Schofield, Merrill Lynch

Thank you, good afternoon. Just a couple of questions for Corrado. Seriously, obviously a rather large working capital outflow during third quarter, can you just give further guidance on what you’d expect in the fourth quarter and particularly with the higher crude prices we've seen? And, secondly, can you give an indication of the effect on Italian GAAP from the major power shutdown next year? Thank you.

Corrado Costanzo

Well I'd say that the working capital is always difficult to predict when you're talking about impact around €50m. It's like, you know, it's one, maybe two cargoes of oil or products and so these are not considered as major variations given the size of the refinery. As I said, we look at changes between say of €50m, maybe even €100m as things that might happen quite randomly. Overall – as Dario pointed out at the beginning of the call – when prices rise, working capital tends to be higher. That's a fact of life so I would not expect sharp reductions, but you can never rule out a reversal due to temporary reasons. So overall let's say stable but again with last minute changes that nobody can predict, especially on the 31st December because sea conditions might be quite rough and you might not be able to ship product, for instance, for a few days, and that might have an impact that will be then reversed, say at the end of March, when the weather is usually better. Having said that so it's a combination of oil prices and sometimes quite random factors. Sorry but I'm not able to give you firm guidance.

The second question was the effect on Italian GAAP numbers of the turnaround; those could be around €20m roughly.

James Schofield, Merrill Lynch

Brilliant thanks a lot Corrado.

Thomas Adolff, Credit Suisse

Good afternoon. Three questions please. Just going back to working capital, given the high oil price environment obviously that's kind of a burden for a lot of the refiners, so have you considered options to reduce that such as syndicating receivables or outsourcing inventories to third parties? Second question is just on the cost savings; you're targeting €10m by year, and have you realised any of that or was that expected in the fourth quarter and on what basis was that the basis of 2009 fixed costs? And the last question I have is to go into slide 23 of your presentation – your expectation for EMC benchmark margin of 0.5 to 1.5 – now let's take the mid point of that and assume a one and a half to $2 premia over EMC, essentially, are you saying you're going to be fairly neutral at the EBITDA line in 2011 or slightly positive? Thank you.

Corrado Costanzo

To answer the first question – and then maybe Dario can also give you more insight on the other issues – well, we do not, well, yes, working capital, certainly there's a lot of focus as you might imagine every time that the oil prices rise and this focus is even bigger on optimising inventory levels and working capital levels and yes some optimisation is still available and we're still working on that. At the same time, we have considered other more radical options like selling inventory to third parties as you said, or doing things on receivables, but, quite frankly, we believe that these are <u>very expensive</u> options, I underline <u>very expensive</u> options. Also all the different, you know, the documentation, is very burdensome and at the end of the day we still have a very, very high availability of unused lines of credit and therefore these would be just very expensive cosmetic transactions and we are not really in a position to have to proceed with those. Dario, maybe you want to say something on EMC?

Dario Scaffardi

Thank you, Corrado. Well, again just to say a couple of things more on what Corrado was saying: every time in the years that we've been in this business – and it’s quite some time now – every time crude prices rise, banks come to refiners like us and offer all kinds of services to reduce working capital and actually the costs of these services generally are staggering and it’s very difficult to see any real business reason why one should do so because financing for the purchase of crude oil is something that is readily available, something that, as a matter of interest to all trading companies or big trading companies to have all their crude which is totally financed so really it’s reinforcing what Corrado was saying; it’s purely cosmetic. It would not really affect in any tangible way the actual business so we don’t really see any reason to do it.

In terms of cost saving: yes, we have a fixed sum baseline based on actual performances over the year 2009 and we have already obtained about €10m benefit as of now, and we project to have something more by the end of the year if everything goes according to plan.

In terms of your last questions: yes, if the EMC benchmark is around let’s say a dollar and we're able to add about a couple of dollars, assuming that there is a slightly better conversion margin, but also considering the operations that we do to take full advantage of the actual structure of the market, yes, at EBITDA level, we should be around neutral hopefully. Let’s hope that this is the scenario we will see in 2011.

Thomas Adolff, Credit Suisse

Okay just a quick follow-up question on your throughput guidance for the fourth quarter. You've basically marginally lowered that. I was just curious; why that is the case?

Massimo Vacca

It’s simple fine tuning, you know, it really hasn’t changed at all. It is 0.05ml/tons: meaningless.

Thomas Adolff, Credit Suisse

Oh right. Thank you.

Lydia Rainforth, Barclays Capital

Good afternoon, gentlemen, just a few tidying-up questions actually, if I could, please, firstly on the hedging instruments; are you able to give a volume of what volume you’re using those derivatives for? And then, secondly, just obviously, we saw very high margins during October, and I'm just wondering whether you sold additional volumes out of inventory during that period? And then, just finally, have you seen any impact in terms of the crude that you’re processing from the Iranian sanctions that have been put in place? Thank you.

Dario Scaffardi

Well, on the Iranian sanctions, just to start from the easiest question, it is of course fully legal, according to European directives, to purchase crude oil from Iran. It is becoming a little bit more difficult because many financial institutions are unwilling to make payments to Iran, so it has of course become something of a challenge – something of a challenge that also could have a negative impact on the market. I hope that this sort of situation will be resolved one way or the other, because already there is a certain amount of tightness on sour crude so it would further create imbalances on the market which are not helpful at all.

On the margin situation: well, our policy is to run at minimal inventory so we don’t store products for the sake of storing products, we are in the business of selling products. We do make operations in order to take advantage of the structure of the market, so we might sell products pricing them forward so this might happen, but the general policy that we have is to sell everything that we have and keep the inventory levels to the minimum operationally possible. We have a refinery which runs 300,000 barrels a day and our average monthly storage is in the range at the period of one, 1.1 million tonnes, or seven or eight million barrels. So we always try to target this level and we don’t speculate in terms of storing products to sell them forward. If we decide to do that we do that from a different perspective: we sell products and we hedge and fix prices forward. So we don’t speculate by storing unhedged barrels apart from what is absolutely necessary, of course, to maintain the business.

In terms of volume hedging – I think maybe Corrado can help a little bit – in any case, what we do is that we are selling in the range of 500 to 600, to 700,000 tonnes of diesel per month and about half of these volumes are hedged, as I said, about half go through fixed channels which do not need hedging, the other half are placed on the open market so the physical pricing may not be the same as the ones that we need to adjust our books. So let’s say that, in terms of diesel, we are probably, on a monthly basis, on something in the range of about 300,000 tonnes. In terms of crude, we run again 300,000 barrels a day, roughly about half of that in terms of crude is what we hedge.

Lydia Rainforth, Barclays Capital

Okay that's very helpful. Thank you very much.

Domenico Ghilotti, Equita

Good afternoon. I have a question on the project financing of Sarlux. I would like to understand why you decided to close the project financing. What is the potential benefit for you?

Corrado Costanzo

Well, it was a long overdue decision. These structured finance deals are usually very cumbersome, you have an agent, you have a department within the company that has to make sure that we're never in breach of anything, you have very, very tight insurance policies to follow which exceed by far what an independently-run corporate would actually choose to incur. So it’s not only the price that the non-reconstructed finance carries with the transaction, but a lot of bells and whistles that at some point in time, when the amount which is still due is like a tenth of the initial amount, really don’t make sense and in terms of overall cost become totally unreasonable.

Domenico Ghilotti, Equita

Okay, thank you.

Alex Marie, Exane BNP Paribas

Hi, good afternoon everyone, just a few questions for me please: you've given some guidance on refinery runs as well as your expectations for the EMC benchmark next year, so could you possibly give us some further view of your CAPEX next year based on your expectations? Second question:

about the dollar, could you please just remind us what is your hedging policy on the Euro/Dollar? And finally, just a broader outlook question; we've seen very few refinery closures in Europe so far and would you expect some more refinery closures in the near future, or is it something that we are definitely not going to see? And just a final question, actually: on your gas exploration of Sardinia, you actually mention exploration wells in the press release, so is it something that you're planning in the near term as well? Are you actually looking for a rig? What's going on, on that side? Thank you.

Corrado Costanzo

One quick answer on the dollar first and then Dario can explain. The dollar policy is basically mirroring the policy on crude and products. We try and smooth things out and stay as close as we can to monthly averages. We do not usually take major views on the dollar long term. We believe that taking major views on any commodity – say six months or one year out – basically does not add or take anything from staying open because, overall, these long term hedges are usually very expensive and also might produce quite wild impacts on your P & L. So overall we've done a lot of studies but overall major long term directional hedges very seldom prove to be beneficial. We stay shorter term as we do with oil hedges.

Dario Scaffardi

CAPEX is more or less what we have, the same as the guidance that we gave for 2010, so within a range of between €110m and €130m is what we expect for next year. Then you were asking about wells: well, there is nothing new compared to what we have said in the last call. We are at the moment in an authorisation process with the Italian authorities in order to obtain the permission to actually drill exploratory wells. Unfortunately, these sort of things in Italy always tend to be rather slow, so we expect to have the authorisations some time in 2011, and the earliest possible that we can really think of drilling the first exploratory well, if everything goes well, is late 2011 and delays are, of course, possible. I mean, at this moment, at this stage, I could really not say, I mean, you know, if this authorisation process will be expedited quickly or there could be political reasons. After the BP event with the Macondo well there has been an uprising against exploratory work offshore – and there's actually even been a ban in Italy – and in a totally unreasonable way, but this is a fact of life. Even onshore exploratory activity is definitely under public scrutiny, so I would not rule out delays. But our plan is to have maybe a first well by the end of 2011, if everything goes well and as expected.

In terms of refinery closures, this is something everybody talks about; everybody talks about closing refineries and never about opening them, but actually, in reality – I mean this is a more modest process but there have been several closures in Europe. At the moment, in Italy, there are rumours, very strong rumours actually, that the refinery which Tamoil owns and operates in Northern Italy close to the city of Cremona will be closed and converted into a depot. I have no confirmation of this but this is a strong rumour. So there are rationalisations happening at a slow pace, difficult to imagine that there will be any significant closures since the majority of the refineries that are still in operation are generally good quality assets that have every reason to exist, particularly if you think that Europe is short on products. It is slightly long on gasoline but it is a net importer of diesel, so it's very difficult to understand why Europe should close down its refineries and rely on other refineries. This is, of course, more of a political question than a market question, but the insistence on closing assets in Europe and relying on assets based elsewhere in the world is not – in my opinion – a very sane business model.

Massimo Vacca

There is, Alex, perhaps one more consideration related to what happened when, for example, Total announced the closure of refineries in France and strikes, and you've seen that being in France – actually, you're not in France, you're in London – but you're aware of the situation. So it is likely that some refineries will actually be converted into depots but that will be a sort of a silent process rather than with big announcements of closures.

Alex Marie, Exane BNP Paribas

Okay, thank you.

Marianna Primiceri, Cheuvreux

Yes, sorry if I come back to fixed costs, but I'm not sure I really got your answer. So you said €10m fixed costs benefit were already realised in nine months?

Dario Scaffardi

We expect both, not only fixed costs but also variable of course because one of the important aspects that we are looking at in our efficiency programme is based for a very strong part on variable cost which is on consumption and losses, a big part of our project is our reducing consumption and on this we have already obtained important results. Part of this programme is also based on reducing the cost not only of variable materials but also what we habitually pay for materials and for work, so it's a broad 360 degree programme which is working both on variable and fixed costs.

Marianna Primiceri, Cheuvreux

So the €10m refers to fixed costs and also to variable costs?

Dario Scaffardi

Yes.

Marianna Primiceri, Cheuvreux

Okay, thank you.

Nidaa Bakhsh, Bloomberg News

Good afternoon. I've just got a quick question regarding some stories my colleagues have written about SARAS in talks with Socar trading of Azerbaijan for the purchase of the Sarroch refinery, I mean, to me it seems a bit unlikely, but I just needed to double-check with you whether you are in talks with Socar about a possible purchase of the Sarroch refinery? Thank you.

Dario Scaffardi

As I already said, we have no comment on this matter.

Nidaa Bakhsh, Bloomberg News

Okay, thanks a lot.

Dario Scaffardi

You're welcome.

Closing Comments

Massimo Vacca

Okay, then if there are no more questions, thank you very much for joining us this evening, and we'll be talking again when the next results come out. Thank you and good evening.