



Second Quarter & First Half 2011 Results

10 August 2011

Welcome

Massimo Vacca

Head of Investor Relations

Thank you very much. Ladies and gentlemen, first of all good afternoon and thank you for joining us this evening for the SARAS conference call on the Second Quarter and First Half 2011 Results. We trust you have all received the copy of the analysts' presentation which we will discuss today; however, if you don't have a copy yet you can download it on our website in the section dedicated to Investor Relations.

Moving on to the agenda today, we will start as usual with an introduction from our General Manager, Dario Scaffardi. He will give you the overview of the group results and then he will cover the highlights of the period. We will then move on to Corrado Costanzo, Chief Financial Officer, who will provide a detailed review of the results for each business segment and subsequently he 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.

2011 Overview

Dario Scaffardi

General Manager, SARAS

I. Highlights

Thank you Massimo. Good afternoon ladies and gentlemen and thank you very much for joining us this afternoon. This quarter is characterised by three main subjects for SARAS. First of all during April/May we have had the ten-year turnaround of our IGCC Unit. Certain parts of this unit had not been overhauled since this plant was completed in 2001 and this turnaround, which has been an impressive turnaround in terms of technical challenges involved, has gone very well. We have been able to broadly remain within the scheduled budget and scheduled time, although we did have some setbacks, but not due to ourselves.



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A second important element in this quarter has been, of course, the Libyan crisis. This has caused a squeeze in global margins irrespective of the fact that one is able to use or not Libyan crudes. Libya used to be an important supplier for SARAS, of course, and I must say that we are quite proud of the achievement by our people who have been able to maintain runs more or less in line with what has been scheduled, notwithstanding the complete absence of any Libyan crude. This has been particularly felt in Q2, since in Q1 there was still some inventory. So both from an industrial point of view the challenge of running different crudes from those we have been traditionally used to running has been faced and overcome very positively, and also from the commercial side we have been able to find alternative sources of supply that unfortunately are not as competitive as Libya but still are an interesting alternative. The market is evolving in this respect so we expect to see some developments.

The third main highlight I would like to give for this quarter is the results of our Marketing Segment, which have been very positive. Our Marketing Segment has been overhauled in the sense that it has been completely integrated within the Supply and Trading department in order to have the same view of the market. In a market characterised by extreme volatility as we have today, it is of paramount importance to manage the price fluctuations and the risk of inventory in a coordinated, comprehensive way. So we have worked a lot in order to streamline our organisation and follow an integrated approach. So Corrado will be able to give a little bit more detail on exactly what has been done.

I would like to point out the strong financial position; notwithstanding everything that happened, we have been able to maintain broadly in line, actually improving a bit, to what was the closure of last year.

Markets have ... we have seen everything in this quarter. Brent touched I think its second historical high. It reached \$126 in April and I would say that probably one of the most worrisome things is not so much the absolute price of crude but, as a side effect of the Libyan crisis, we have had all the differentials – particularly of sweet crude oils – that have strengthened significantly. So just to give a benchmark number: Azeri light that used to trade in a range between \$1 and \$2 premium to Brent has gone up to the range of \$4 to \$6, so even with the structure of crack spreads remaining broadly in line with what we experienced in previous quarters and if we look at the five-year average for some products has been either better or at least in line this, compounded with the absolute price of crude which affects directly variable costs, this has given a hit to refining margins, unfortunately.

Also the situation in the US, with WTI being at a \$20 discount and sometimes more than that on Brent, has negatively affected our market in two ways: one, it has made it extremely interesting for American refineries to produce diesel and market it in Europe, so there has been a further depressing effect on margins, and also it has altered the supply balance of crude oils, since many crude oils that were traditionally targeting the US market are now moving towards the East and Europe.

In this scenario, if we look at the margins that SARAS has achieved – again a difficult and challenging quarter, but we have been able to broadly maintain a level of above \$4 for the overall site margin, actually \$4.7, while the EMC benchmark has touched an absolute historical minimum of -1.8.



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The Libyan crisis has in a way also helped the sour differentials, since the heavy/light differential which we use as a reference – the Brent Euros spread – went from \$1.2 in Q4 of last year to something like \$3.5 in Q2.

Corrado will be able to go a little bit more in depth in the various segments.

Corrado Costanzo **CFO, SARAS**

Segment Reviews

I. Refining

Well thank you, Dario. Let's start as usual with refining.

Well, first of all, let me say that Q2 is very seldom a very profitable quarter because it's typically a heavy maintenance-type quarter and this year was not an exception and to an extent also there was even more maintenance in one crude distillation unit, so crude runs were slightly down compared to last year.

In spite of this scheduled maintenance, we were still able – as Dario was saying – to improve on the EMC benchmark margin significantly by something like over \$2 per barrel, which is, we believe, impressive, impressive also given a certain impact coming from the Libyan crisis. Clearly our people were absolutely brilliant in maximising the use of the cracking units, in spite of the absence of certain crudes, in maximising the profitability of the alternative crudes that we sourced from traditional counterparts like the Azeri but also non-traditional counterparts. So the effect was minimised but it was not zero and this impact – the overall impact on average – is discussed more in depth in the Outlook section, but there was an impact from that also.

And also another significant impact was the reversal of an approximately €20m gain that we posted in our comparable EBITDA in Q1, due to the fact that we had depleted certain intermediate-products inventory before the scheduled maintenance cycle and then we rebuilt the same levels of inventory. So this was – as we said during the last call – a temporary effect and we warned that there would be the opposite effect in the following quarters and this happened, and there was a big number, about €20m, equivalent to the gain in the first quarter but certainly a big number for Q2.

So overall we are certainly satisfied that in a difficult environment during the maintenance cycle we were still able to come up with reasonable numbers.



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1. Refining – Production and Crude Oil Slate

Moving on to yield, production and crude oil slate are very difficult to comment on, on a quarterly basis, so I would simply not do that. The only relevant information here is that since we have this ten-year major maintenance at the IGCC level, the refinery production was geared not towards production of tar but more towards fuel oil, and this was clearly a temporary effect which will be reversed in the following quarters since things are back to normal since quite a long time. So no real significance looking at these numbers.

2. Refining – Fixed & Variable Costs

Instead, the fixed cost numbers are much more significant. We have announced a major improvement and overhaul programme called Focus and part of that programme is geared towards improving fixed costs. We've said at the end of last year that fixed costs would be lower in 2011, more around €220m, and we are certainly on track, as you can see. We're about €110m after six months. We will be more specific during the next call about next year's fixed costs but we are still insisting on this particular area and we believe that next year fixed costs will be even lower and we are certainly excited about the initial successes.

II. Power Generation

Moving on to power generation. So IFRS EBITDA is always more or less the same – as you all know – at this point, because of this equalisation accounting technique: only sales of hydrogen and steam can have an impact on EBITDA on a quarterly basis, everything else being equalised. So clearly it was impacted during Q2 because of the ten-year major maintenance cycle.

On Italian GAAP EBITDA, things are much more evident. There was a sharp drop which was, for the most part, anticipated and unfortunately of course another significant part – something close to €10m – was not anticipated. You know, the nearby dedicated oxygen production plant which belongs to a very well known international company and has operated impeccably for ten years was undergoing the same kind of major ten-year maintenance, and unfortunately they had problems starting up after the maintenance and basically we were idle for quite some time after we were ready to go back into full-steam operation and that had an unexpected negative impact. However, our plant is now back to full operation and their plant is also back to full operation. So everything is back to normal at this point.

1. Power Generation – Fixed and variable costs

Also fixed costs for the IGCC: we're working on those as well. The trend is also clear there, so – as I said – things are developing, but these successes cannot arrive overnight. It will take some time but we believe that we are on the right track.



III. Marketing

Marketing. Well first of all let's talk about Italy. Italy increased its volumes vis-à-vis the same period of last year and – also to an extent even in a difficult environment – margins also rose slightly. So we are very satisfied in that respect.

Spain is an even more difficult environment. We are still keen on rationalising sales volumes. We are basically cutting on most, if not all, unprofitable sales. We are perfectly aware of the fact that this is a working-capital intensive sector and therefore even unprofitable sales require significant investment in terms of working capital and so we're very, very strict on that at this point and also, as Dario was saying, this is part of a general rationalisation and the supply function has been centralised. Also inventory management has been centralised and as a result of all these rationalisation measures there was a very, very good financial result for the quarter.

Clearly these measures have some one-off type elements, so we have to say that these numbers are not necessarily repeatable in the future at the same level.

IV. Wind

Moving on to Wind, Wind had probably one of its worst quarters. Basically there was no wind and therefore that showed in the EBITDA. We will ... even if – as we already have said the last time – the plant has been upgraded to 96 megawatts; however, due to weather conditions it did not help and we know that in Q3 wind conditions are back to normal and the plant is fully operational with 96 megawatts.

V. Others

And other segments, I mean, always have very small numbers so I will skip on that.

Financials

I. Key Cash Flow Figures

I'd like to say just a few words on the key cash flow figures and CAPEX. CAPEX is absolutely in line with the guidance and is tightly under control and totally in line with overall market conditions, so one of the key elements for controlling overall debt levels for the group – besides working capital and marketing – is also capital expenditure, which has dropped very, very significantly from the year 2009 into 2010 and more so into 2011 without, I have to say, any significant impact on operations.

Then I'd also like to add that the net financial position, which has even improved from six months ago from €60m to €30m roughly, could have been even more impressive because at refinery level our inventories are much higher than they were at the end of last year. We're talking about almost 1.6m tonnes vis-à-vis something like 1.2m tonnes. We had a lot more crude oil and this was a consequence of more aggressive commercial policies. Since margins are so tight, clearly one of our key objectives is to optimise sourcing. Dario will be more specific on this. So at this point if we



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find a good deal on a crude cargo we just snap it up, which means that inventory levels will fluctuate more widely in the foreseeable future, but on the other hand it has to be said that we also have a lot of money tied up period on period and we're talking about probably a couple of hundred million Euros tied up in an inventory. It's a totally reversible situation, it's not a strictly operational inventory but it's more due to a broader view of how to run operations in today's market.

And at this point I'd like Dario to continue with Outlook and Strategy.

Outlook and Strategy

Dario Scaffardi

I. Outlook & Strategy

1. 2011 Maintenance Schedule

Thanks Corrado. Looking at our maintenance schedule, we have completed in Q2 the ten-year turnaround, as I mentioned before, of the IGCC plant and also in the same period, to minimise the impact of maintenance, we have maintained also various other units to fit it in together in the shadow of the main turnaround.

During the rest of the year, we have some turnarounds on HDS units and some slowdowns on our reformer and periodic cleaning of the Visbreaker, nothing major, nothing unexpected.

The schedule for 2012 will be released in the next call in November.

2. Strategy

Looking at our outlook, we have focused in the last 18 months very strongly on our asset management programme, which is called Focus. This is now in its second year. Let me remind you that this programme has the primary aim of improving efficiency, effectiveness and reducing cost.

We have had overall very positive results, albeit mixed results. We have had some very encouraging progress – and I would say quick progress – in terms of cost-cutting. We have been able to identify, as Corrado was mentioning, a wide area of cost optimisations and we've had some very positive results in terms of efficiency. We've been able to extract more from certain units, while a very important area of improvement – which is energy containment, or energy saving – is proving to be more challenging and we have dedicated extra efforts and extra resources to this very important topic in the moment in which the prices of crude oil certainly influences, the absolute price influences very dramatically the cost structure.

We have also decided, together with the re-enactment of part of our investment plan, we have decided to complete the work which was already carried out for roughly 50% on our mild hydrocracking unit. We have also decided to broaden the scope of our investment projects by including all so-called minor projects, which are extremely important in the management of



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refining, which involves mainly energy and utilities and any project which has a quick payment time would be definitely examined and probably approved by the board.

We have also decided to extend the scope of our renewal. We are looking very closely also at the areas of Planning and Supply & Trading. In this market in which the daily volatility is higher than the refining margin and with an environment of very high prices, of course the management of crude oil purchases and product sales becomes absolutely paramount, so we have decided to slightly alter the focus and move from an industrial-driven attitude that generally was focused on optimising crude runs at refinery level, today we are looking to be a little bit more proactive and optimise the purchase and sales structure and, secondarily, optimise the refinery runs. This is something which is absolutely necessary to do in this type of environment with low margins, which I think – at least for this year – are probably here to stay, and high oil prices. Even more than high oil prices I would say that price volatility is extremely important in this, so we are taking a close look as to how to manage this.

Most probably we will create separate companies for various activities, mainly the commercial activities, in order to be able to take full advantage of opportunities that can arise. We have seen a sample of this already with the marketing, which has started to be fully integrated, and there is scope for doing more.

We are reviewing the overall organisational structure of the company. We are employing and appointing new senior managers, which come from within the industry and out of the industry, who have a lot of experience and will certainly help drive the change that we need to enact. For this reason, we have also decided to create a company specifically devoted to gas exploration in Sardinia. Since the last call there have been no major developments. We still have the very positive analysis and we are in the process... in the permitting phase with the authorities in order to decide to have all the permits necessary to start to drill a test well, which most probably will not be able to happen in 2011, but will probably happen in 2012.

Thank you for listening to us. We are quite happy now to answer any questions which you might have.

Questions and Answers

Question 1 - Hootan Yazhari, Merrill Lynch

Hi there, gentlemen. A quick and simple question. You've obviously had some good success with cutting your fixed costs in the refining business: can you just give us some colour as to what sort of things you've been doing to get those cost cuts and what level we should be thinking about for full-year cost-cutting on the fixed-cost side?

Dario Scaffardi

Well Hootan, thanks for your question, I think Corrado can give you more colour than me on the impact and the long-term impact. In terms of what type of cost we are cutting, basically a large



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refinery such as ours has a very wide base of contractors that provide numerous services to us, so on the one side we have acted upon all our suppliers in order to optimise costs, internally, we have tried to cut unnecessary items which we were purchasing and, thirdly, we are in the phase of doing more in-sourcing and less outsourcing. So I would say that these are the three main areas on which we are concentrating our cost-cutting. I would say that Corrado maybe is able to help a little bit better than me on the actual figures.

Corrado Costanzo

Well, actual figures, Hootan, are going to be – for the refinery – more or less in line with the guidance, around €220m, and I'm not sure we gave a guidance for Sarlux, but also Sarlux's costs will be lower than last year. So more toward €90m end of year, €90-95m, which is another 10% reduction more or less vis-à-vis the €104 of 2010 and this is going to be 2011.

We are still working on the same factors which Dario was mentioning and working hard on those factors and therefore we anticipate that the 2012 fixed costs will be lower. However, we usually like to be fairly specific when we give our guidances and I think that 2012 we can anticipate that it should be lower than 2011 but how much lower we would like to tell you about during the next call once the budgeting process is more advanced than it is today; however, lower in 2012.

Hootan Yazhari

Understood, thank you very much.

Question 2 - Thomas Adolff, Credit Suisse

Good afternoon gentlemen, a few questions please. Firstly just around your discussions on inventories, just to clarify, you said you want to optimise sales and the purchase of cargoes etc. over refinery runs, which was previously the case i.e. the focus on the refinery runs, is this reflective of your concerns over the balance sheet and cash flow given the high commodity price environment and also reflective now of your cautious stance on the near-term refining margin environment? And related to inventories also, I guess a function of holding onto more inventories year-on-year is also a function of having zero third-party processing contracts and I was wondering what progress you're making with respect to that?

Second quick question is just on the marketing business. So when I look at the comparable EBITDA, which is quite impressive at €28m, when I look at the number in Q2 2010, which was about €15m, the delta of 12, how much of that is explained by lower inventory levels during this quarter, which is obviously a one-off item?

And the final question I guess I have is on fixed costs: you say 2012 fixed costs are likely to be lower than the €220m you're guiding to for 2011. I remember previously you talked about inflation, is inflation no longer a concern for you? Thank you.



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Corrado Costanzo

Well, yeah, inflation is a concern but in the real world, i.e. during a recession, sometimes you can still lower your costs regardless of a few percent inflation. In practice it doesn't really have a major impact.

On cash flow related to inventories – before Dario goes into the specifics of our trading and industrial operations – as I said before, inventories will be more volatile because of this new attitude, as you mention lower inventories, higher inventories that doesn't mean that we will take fully open positions for huge amounts of inventories. As you can see we tend to hedge most of our positions. That means instead that if we find a cargo which is sensibly priced, then we will snap it up regardless of inventory levels at a certain date. If we don't we will find that inventory levels will be lower. So working capital will be more volatile in that respect. We do have the credit lines available to be more proactive like that. So expect more volatility rather than levels which will be permanently higher.

Dario Scaffardi

Yeah, let me reinforce what Corrado was saying. In order to try to give a metaphor of the situation, prior to the Libyan crisis, in a way we had the equivalent of a faucet which could be opened and closed at will, having 24-36 hours' voyage time. So we could more or less, within reason, purchase or not purchase crude in a very evenly averaged way and this helped maintain low inventories. In the current situation, without Libya, we have to be proactive in finding crudes that may have a very long haul to come, so we do not use the inventory as a mantra any more in order to minimise it, we have to have the flexibility to grow inventory levels because of opportunities that we might find. We manage this of course, but it is much more important to be able to source competitive and convenient sources of supplies at the right moment rather than maintaining minimum inventories, although of course we keep a tight control of that.

Regarding the marketing business, you were asking about the difference in comparable EBITDA. A fair amount of that is attributable to the fact that we have optimised inventories also in Spain. So we have moved down more or less by about a cargo in the inventory held in Spain and that helped of course. It also helped during this period that we were able to optimise purchases, since our refinery was in shutdown. Although we have big term contracts with many customers, we have maintained these contracts by trading on the market so we have been able also to capitalise on these opportunities.

Thomas Adolff

Perfect. Thanks. Just on the third-party processing contracts, are you making any progress on this?

Dario Scaffardi

Unfortunately not. With an EMC at -1.8 we don't have people banging on our doors at the moment.

Thomas Adolff

Okay, thank you.



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Question 3 - Dan Ekstein, UBS

Hi, thanks, good afternoon everyone. I've got three questions. Firstly I'm interested in the comments you've made on the trading operations being more closely integrated with the refinery. It seems that you may be placing more capital at risk in these expanded trading operations. I'm trying to understand if you're going to be making bets on the market into the refineries becoming a tool for your trading operation. Is that the right interpretation?

Dario Scaffardi

Dan, if I can answer right away and then you go ahead with your next questions. Absolutely not. Personally I've been involved in trading for many years and trading is all about managing risk, not creating risk. So taking outright positions on something is something that anybody can do but then generally people don't get this right and they generally get it wrong and I'm probably older than you are and I've seen quite a few companies do this and end up quite badly. The very successful international traders, all of whom are well known to you, do exactly the opposite: they do not take risks or they take a limited amount of risk in relation to their financial capacity. So trading is not about hoping to get the market right, because anybody can do that with a screen. You don't need to do anything, just get a computer and an account with the exchange and you can do all the trading that you want. Trading is about managing risk, taking positions and managing it. So no, our risk structure would not increase in any significant way. Probably not zero, probably not zero, because it's impossible to have a 100% hedge, but certainly in a marginal way.

Dan Ekstein

Okay, the next question was how much you are going to commit to the gas exploration campaign at the end of this year?

And the third question was: as regards your investment plan going forward and the €60m investment you've made, what kind of base case upgrading spread do you use in your planning assumptions when you are assessing those investments? Thanks.

Dario Scaffardi

Thank you Dan. It's a good question and offhand I don't remember, so I think that, starting from your last question, Massimo will come back to you hopefully tomorrow, maybe later this afternoon and be able to give you a little bit more detail. Offhand I don't remember, we'll look it up.

In terms of gas exploration, by the end of this year we should spend something in the range of about €10m roughly and for the whole project. So how much is going to be spent now, how much is going to be spent in 2012? I think that in 2011 actual spend is going to be relatively small. The actual work is going to be carried out more in 2012, most likely.

Corrado Costanzo

So going back to the base case scenario that was used to run our projections on the mild hydrocracking upgrade, which is going to cost €60m, the base case scenario for those return calculations is broadly in line with today's market conditions and the reason why this investment



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makes a lot of sense anyway, even in today's market conditions, comes from the fact that we have sizeable sunk costs relating to the level of investment. The overall cost of the upgrade exceeds in a fairly significant way the €60m, but anyway all that extra cost is already in our financial position since quite a long time. In fact, we had a certain investment plan in 2008 which was then totally overhauled in 2009 and part of the upgrade has already been started. So sunk costs are sunk costs, the money is not working for you, it's just there. So we decided okay what if we spend an extra €60m in today's environment and the returns are very good even in today's environment, probably. Certainly the returns wouldn't be as good if we were to spend 100% of the money which would be required today. Okay? So you shouldn't be surprised by the fact that we decided to go on with that upgrade. It's really related to the amount of sunk costs.

Dan Ekstein

Okay, that's helpful, thank you.

Question 4 - Domenico Ghilotti, Equita

Good afternoon. I have a clarification on the reduction in the inventory level and so I would like to better understand the impact that it can have on your overall working capital and on the cash position, because you mention a couple of hundred million Euros, this is probably related to the reduction in inventory, but maybe you have also some payables in fact in your overall working capital?

Corrado Costanzo

Well, I mean, I just said that our inventory levels were €1.2m at the end of last year and after six months at the end of June they were at €1.6m, and most of that was related to higher crude oil inventories and to the new trading policy which has been discussed so far. So those are ... and I was focusing on the fact that it's absolutely reversible if we wish to do so, and therefore there is scope for reduction in net debt. Having said that, I also pointed out that we should expect and you should expect more volatile inventory levels in the future and Dario also has been very adamant about the fact that, however, we will not sit on those inventory levels without hedging, trading is a different thing, we will look for good deals around the world and not necessarily take huge open positions. Actually we will not take huge open positions. So this is the summary.

Domenico Ghilotti

And another question on the outlook that you gave for oil runs. You will reduce the oil runs for the second half: can you also elaborate a little on this?

Dario Scaffardi

So oil runs have been slightly reduced in the second half because we have not been able to optimise fully the plans due to the absence of Libyan crudes. So as long as we have not been able to find the perfect substitute, or upgrade our plans in order to be able to run without – we have been extremely successful in this respect – we will have a little bit of penalisation on actual runs, which will be slightly lower than the maximum. This has been also included in that guidance that has been given of an impact of \$0.3 to \$0.5 per barrel because of certain specific qualities.



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Domenico Ghilotti

Okay, thank you.

Closing Comments

Massimo Vacca

Okay, so thank you very much for joining us this evening and we look forward to the next appointment. Good evening to everyone.