



# **Third Quarter 2012 Results**

**14th November 2012**

## **Welcome**

**Massimo Vacca**

**Head of Investor Relations**

Thank you. Ladies and gentlemen good afternoon. Thank you for joining us for SARAS' third quarter 2012 conference call results. I trust you all received a copy of the analyst presentation which we will discuss today. However should you need a copy you can download it from our website either directly from the homepage or the section dedicated to the investor relations.

Our agenda today will be the usual one. We will start with Mr Scaffardi, General Manager who will begin with the overview of the group results and he will cover the highlights of the period. Subsequently, Mr Corrado Costanzo, Chief Financial Officer, will provide the detailed review of the results of each business segment and he will also discuss the group key financials. And afterwards back to Mr Scaffardi for the market outlook and the strategy. Finally we will be taking your questions. Thank you. Dario.

## **2012 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 this call. Q3 of this year has been characterised by a strong rebound of the refining margins. The main drivers behind this were tight inventory levels, unexpected refinery outages, both in Europe and the US and a particularly tight market on gasoline. Within these conditions our refinery has had an excellent operational performance. We've been running at full capacity and have been able to capture the full favourable margin of this scenario and also our power generation, wind and marketing segments all had very satisfactory results in line with expectations. So the overall group



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reported EBITDA has been almost €240m while at comparable level we are at €145m with an adjusted net result of almost €50m.

Finally I would like to point out the extremely solid financial performance with the excellent results that we have achieved on the optimisation programme on the working capital as Corrado will be able to outline later on in the presentation.

In terms of the market in Q3 the crude oil prices inverted their downward trend and recovered the majority of the lost ground so we moved from an area in the 90s back into the 100, 110 bracket. There was the very serious condition of the Iranian embargo which came into full effect nominally on the 1<sup>st</sup> July but its effects had already been felt in May and in June. The market reacted to this of course and we saw a change in the crude oil differentials for sour crude particularly the benchmark quotation of Urals in the Med moved from an area around between minus one and a half and minus two and moved swiftly up into positive range in July only to move back towards a more balanced minus one level between late August and September signalling that the market was basically able to recover from the outage of Iranian for a variety of reasons, maybe because a good part of the Iranian crude has been flowing in any case to other destinations.

There has been a strong increase in exports from Iraq. So all in all the market on sour grades has been reasonably balanced and reasonably well supplied. So apart from the immediate effects following the coming into force of the sanctions the market was able to recover fairly quickly. This is a market in which although the prices are still extremely high it tends to be pretty well supplied in terms of crude.

Also the differentials for light grades have come down a bit during the quarter to more reasonable levels. The premium for instance for Azeri crude has been in the range between \$1 and \$2 premium to Brent as an average, maybe slightly on the higher side than that.

On the product side we had very, very strong gasoline cracks, particularly due to a peculiar situation and outages of various refineries on the US east coast, hurricane Isaac, the fire in Venezuela refinery. So a variety of reasons and pushed cracks up almost to the \$20 dollar level which was totally unexpected, unprecedented. Cracks have come in the recent weeks back to rather low levels.

Diesel cracks have been quite healthy in the range in the Med between \$16 and \$20 with a spike in September and also West African crudes are becoming quite available in the Mediterranean helping ease some pressure on crude supplies.

If we look at our refinery margin graph we can see that the EMC benchmark has rebounded significantly and come back to \$3 which is in the historical high range. Conversely also our margin has been quite healthy. We've added on the benchmark about \$2.5 in this quarter thanks to strong diesel cracks, relatively weak high sulphur fuel oil cracks which have contributed to increase our conversion margin.

I would ask Corrado to continue with a more detailed examination of the various segments.



## **Corrado Costanzo**

**CFO, SARAS**

### **I. Segment Reviews**

#### **1. Refining**

Thank you Dario let's start as usual with the refining sector. As you can see finally we posted a positive EBITDA for refining and so the yellow histogram after many disappointing blue histograms with negative EBITDA. Definitely an impact here was felt from the margins that Dario just mentioned. We were fully operational during the quarter, no particular maintenance and in general no operational hiccups either and so production was 9% higher on a year on year basis so this enabled us to fully benefit from finally favourable market conditions.

Also from a financial standpoint compared to the same quarter of last year we also benefited from a stronger Euro/Dollar exchange rate. As you all know we are structurally loaned dollars and most of our costs are denominated in euros so when the dollar appreciates vis-à-vis the euro we actually make more money and so last year the average for the quarter was 1.41 and this year was 1.25. So also on that front overall outside conditions were favourable but I'd like to stress again that this was also combined with a very sound operational performance.

#### **2. Production and Crude Oil Slate**

Moving on to the yield let's focus on nine month yields. As usual quarterly yields are not very useful indicators. The message here is that compared to last year there was no availability of Iranian crudes while last year there was still no availability of Libyan crudes. So in the crude oil slate you do see some changes between the different categories, sweet versus sour crudes, however as we always say what we run is a very complex and very flexible refinery so we are able to cope with the most diverse and challenging outside market conditions so we did not have to lower our runs last year or this year and we were also able to end up with a very sound product slate. So if you look at the middle distillates and the light distillates percentages they're still very high irrespective of very different outside market conditions year on year and this is exactly what we have been telling markets for several years we can cope with very diverse and very challenging oil market conditions and still make money if margins are there of course, also scrape by if margins are not there but again we are very resilient.

#### **3. Fixed and Variable Costs**

Switching to fixed and variable costs, variable costs are embedded in the margins that we communicate and they're also very much linked to energy costs, oil prices and such so yes they're higher but they're embedded in the margins.

So fixed costs firmly under control, the Focus programme is helping here. We've been working hard at shaving off fixed costs even here it has to be said and it is a complex exercise because this is a very, very big asset. However we have been lowering our fixed costs constantly over the last few years.



#### **4. Power Generation**

Power generation also was posting a very solid result especially in terms of Italian GAAP EBITDA, let's forget about IFRS EBITDA which is not particularly useful. Production was slightly lower due to a difference in light maintenance schedule but here we were helped by a very sharp increase in the power tariff. As you can see it moved from 10.6 to 12.5 euros cents per kilowatt hour, it's a 17% increase, very much linked to oil prices. Those about your group that listen to our calls on a regular basis might remember that there is a nine month time lag between the price of oil and the tariff and so the tariff is catching up with the increase in crude oil prices, so very favourable tariff indeed.

#### **5. Fixed and Variable Costs (IT GAAP)**

Here too variable costs, same old story, very much influenced by commodity prices but fixed costs again firmly under control.

### **II. Marketing**

Marketing also looked pretty good during the quarter and I would say that the performance is quite competitive. We were quite impressed ourselves because the market conditions are definitely challenging. Oil consumption both in Italy and Spain where marketing units operate have been going down steadily in the last couple of years because of the overall economic slowdown in these two countries. Yes we have to an extent reduced our sales but we have been able to hold onto very decent margins and so the bottom line is that the variable EBITDA is absolutely in line, if not better, compared to last years.

Italy provides the backbone of this performance. Spain is much more subdued if I had to give you a hint of where the money is really coming from.

### **III. Wind Power**

Wind is always very simple and over nine months the comparable EBITDA is €12.4m, 20% higher than last year. It is basically due over nine months to significantly higher production. Last year was very, very disappointing in terms of availability of wind, I don't know if you can say that and the tariff is more or less in line. So I think we're looking at more average results this year rather than last year.

### **IV. Others**

Also a very, very tiny segment, in the others segments there are small numbers but there's a lot of work there to improve on minor units, it's just an indicator of how much effort is being spent on each and every unit, each and every detail.



## V. Financials

### 1. Key Cash Flow Figures & CAPEX

I'd like to take a look at cash flow figures and talk about our financial position. Net financial position at the end of Q3 was €130m. That is slightly higher than three months ago but when your turnover in three months is like €3bn, €50m more or less is hardly anything, it's just one cargo that left one day earlier or later than anticipated so it's hardly anything. We have to be clear here we can't control working capital down to the last €50m but in general as you can see all the cash flow components are firmly under control, working capital was specifically addressed as part of Project Focus. CAPEX has been scaled down significantly during the last years also because we're very well positioned so we don't really need to invest that much.

And finally we have temporarily benefited from outside events like the Iranian embargo and we have not sorted out that particular issue because it is very complex and it's basically outside of our control. We're talking to the Italian authorities we're talking our Iranian counterparts but it's a very political/legal type of issue at this point and not particularly easy to solve. So we still owe the Iranians a very significant amount of money.

On the other hand though we're also owed a significant amount of money from GNC, the national grid company because we have talked about the tariff for Sarlux which increased from ten euro cents per kilowatt hour to 12 but that's in P & L terms but we haven't seen that money yet because of the mechanics of how we can invoice the national grid company. So we can invoice them based on a provisional price which is based on the previous year's average price. And so we still have to collect that difference. That difference is in our P & L but is not on our balance sheet yet. It's an awful lot of money, we're talking about something around €100m. So positives and negatives there.

This is pretty much it for the key financial issues and so I will pass us back to Dario for the outlook and strategy.

## Outlook and Strategy

**Dario Scaffardi**

### I. Outlook & Strategy

#### 1. Outlook: 2012 Maintenance Schedule

Thank you Corrado. On our maintenance schedule for 2012 nothing more to add to the information which is already available. We have completed actually turnarounds the maintenance on one of our mild hydrocracker units and one of the topping units and also during the month of October we had a planned maintenance which is routine every 14 to 16 months of our gas fires. One was under maintenance and also an important part of the unit which is involved in the production of the cleaning of gas and the production of hydrogen.



## 2. Outlook: 2013 Maintenance Schedule

In 2013 we have a medium to light maintenance schedule. We will complete in Q2 the investment plan on the bigger hydrocracker that we have which I remember was an investment in the upgrading where the addition of the new reactor was approved last year and the final stage of this investment will occur in the second quarter of next year together with a variety of routine and ordinary maintenances during the year. So not really that much in this respect.

## 3. Strategy & Outlook

In terms of our strategy and outlook in our board of director meeting we presented the group business plan for the years 2013 to 2017. By the way we are planning, although this isn't decided yet, to have a meeting and give a little bit more guidance to the financial community on this plan most likely in January of next year and we will give you ample notice when exact dates will be fixed.

This business plan is a very streamlined business plan. We have made some market assumptions based on international consultants in this field. We are projecting a relatively stable crude oil price over the next couple of years and the majority of the consensus of the consultants in this area agree on a more robust scenario for refining margins in the next years with a relatively minor growth but a steady growth over the period.

Our plan is a plan which is mainly focused on people which are the main resource of our company. The whole project that we have taken forward in the past three years, Project Focus, is based on skills, it's based on know-how, it's based on knowledge and we have obtained some pretty encouraging results from this programme which we will continue and push forward.

We see that we don't really have any need for any major CAPEX programme in the foreseeable future. Our refinery is fully equipped to face with the current hardware the scenario in the forthcoming year so there is no major CAPEX plan involved. We do have some possible upgrading plans in the drawers that can be taken out if the market conditions change in a dramatic way. So we, of course, continue to follow the market and see how it develops because in this climate that we have in these days this is absolutely necessary.

We are planning, although they've not been approved yet, the only investment will be most probably in the area of energy conservation and energy efficiency, so a relatively minor investment which we plan to do in the forthcoming years in order to decrease the consumption of fuels in our refinery.

We will continue to pursue efficiency and in this respect the board has also approved to develop a plan to reorganise the company which basically means the transfer of industrial refining activities into a new subsidiary, fully owned by SARAS. This will be an actual evolution of what we have already been doing. Already our business model has been shifting towards a business model which separates the commercial part from the industrial part and this is following the trend of everybody else in the sector and it means that since the resources we can find within our own system are basically efforts in improvements we believe this will enable strongly our people to become more accountable, more responsible for what is in their hands so it will be clearer and easier to define



objectives and obtain results. If I could just point out what Corrado was saying before in our 'Others' section which today is only one company which is called Sartec which is a technical subsidiary although the numbers in absolute value are small I think it's very significant the percentage difference and inversion in trend. And this has been obtained only with better management.

As I already mentioned before in our maintenance we are moving forward. We are in the next year in the final stage of the completion of the mild hydrocracker 2 revamping project which will deliver about five or 600,000 tonnes a year of additional diesel in exchange for higher sulphur gasoils and will enable the refinery to increase runs if the market conditions will justify doing this.

And just as a closing note, very important, we have obtained. very recently. the full authorisation to start building a wind farm in Romania with a capacity of over 100 megawatts but I think Corrado can give a little bit more colour on that. Thank you we will be pleased to take your questions.

## Questions and Answers

### **Thomas Adloff, Credit Suisse**

Good afternoon. Congrats on your results. Just a couple of questions please. Firstly on the receivables from the authorities related to your power gen business, I think you talked about €100m does that fully balance out the Iranian payables?

The second one just on the working capital position, you had a nice inflow last quarter partly explained by the Iranian stuff but this quarter some reversal. Is this the kind of level we should be thinking of in a stable oil price environment?

The final question is just on the fixed cost guidance for 2013 in refining and the group CAPEX guidance if there is one?

### **Corrado Costanzo**

Well Thomas the answer to your first question is no. To be very honest the payables towards the Iranians as we always said is a very significant amount of money so it's a few hundred and on the Sarlux side the positive is about 100 and we're still talking about orders of magnitude here.

Then about working capital there is still room for further optimisation. Clearly as you pointed out prices are a factor here but from an operational standpoint yes there is still room for improvement, probably not dramatic but there's still room for improvement and every improvement here means from a financial standpoint 50 or 100m.

The fixed cost guidance for next year is roughly around the level we're going to have this year so 210, 215, something like that and CAPEX also should be roughly around the level we're projecting for this year also. Bear in mind that we are also complaining because the upgrade of the mild hydrocracker 2 unit which has a tail end amount that will still have to be paid, about 30m and so that alone is a relatively significant amount of money and then everything else will amount to a





total for the group of about 100, 120, pretty much in line with this year's. So fixed costs we anticipate anyway something more or less in line but in real terms it's a reduction, let me say that. So inflation is still here, it's not great but it's still here.

**Thomas Adolff**

I thought I'd follow up with another question maybe just more related to the macro environment, now Q3 has been very, very good partly or mostly explained by unplanned outages etc. now obviously post maintenance we're seeing the impact to the refining margin from still existing spare capacity in the system, equally we've got returning capacity, Richmond, Amuay and Motiva and some additional stuff from next year onwards, I mean you've talked about industry consultants talking about slight improvement, my sense is it's going to stay quite challenging from next year onwards unless we see further rationalisation in the OECD. What's your expectation for 2013 refining margin and what sort of indications are you already seeing in November to give you the indication for what could be next year?

**Dario Scaffardi**

Thank you for the question Thomas because it's certainly a very interesting topic for us. Well of course November has been a rather sudden wakeup call from four very positive months which we're not of course any more use to. Having said that we were of course very much aware that it was a temporary situation we tried to make the most of it but we do understand the overall oil environment continues to be challenging.

Having said that the market is not just a question of making a mass balance of refinery availability, I mean installed distillation capacity is above consumption, luckily, otherwise we would have refining margins which would be shooting up to the stars and our consumers would be very, very disappointed with the gasoline products or with the extra recessionary effects.

The market is shifting, the market is changing. There have been in our area various refinery closures. In Italy alone there is one refinery which is under a one year maintenance and unclear whether it's going to restart or not. Another refinery important which is right in front of us in Rome has been definitely closed. Another refinery in Venice will be shut down next year, I don't remember exactly when. So the overall picture here in our part of the world is changing and we have felt this effect immediately because we have pretty strong demand for diesel products which were not affected by the spike in these three months, which was mostly affecting gasoline. So I think that is rather a positive and I don't want to be overly bullish but it's an encouraging sign at least.

The other encouraging sign is from the supply side. The drivers here are not just refinery availability, it is not just about outright product availability but it's also about crude. This is one of the areas which tend to be sort of neglected. Production of crude is increasing in an important way. On Monday the International Energy Agency released its 2012 outlook. The report is 2012 but the outlook is up to the year 2035 and I would say that the single largest effect that one needs to look at is that the increase, if I remember correctly I'm citing by memory, four million barrels of extra non OPEC crude expected to come on stream by 2020, I may be wrong but in the future. So there is a lot of crude which is coming on stream. As crude buyers we have been able, notwithstanding the fact that Iran is out of the picture, that Syria is out of the picture, that Sudan was out of the picture





until yesterday, that Yemen is out of the picture, and these have all been important suppliers to our area of the world, that notwithstanding we have been in a relatively comfortable position to be able to choose variety of crudes. Our term contracts are almost excessive to our needs and also that we have been able to choose and pick what we like most. The revolution of fine oil and shale gas in the US is making available important quantities of West African crudes that used to target the US market. So there is a variety of reasons why we share the view of market consultants in believing that the outlook for refining margins, although they are not brilliant, are still definitely better than what they have been in the last couple of years.

So for these reasons we are reasonably optimistic.

**Matteo Bonizzoni, Cheuvreux**

Good afternoon. I have a question about the transferral of the refining activities to this new subsidiary. You mentioned that it's to have the commercial activities and industrial activity split and that it makes more sense, I want to ask you if it has an implication as regards let's say a commercial deal or something like that in the future or is it just to have a more slimline structure?

**Dario Scaffardi**

The idea behind it is mainly business oriented and it's mainly on believing that we will be able to extract even more value in this way. So this is the main driver. It is focused, as I was mentioning before, on our people because this is the true resource of our company so this is something that we are developing strongly, knowledge and knowhow. Of course I would ask Corrado to help me explain also about other developments that can be possible in this respect.

**Corrado Costanzo**

Well really yes the answer to your question is yes and more traditional in a way corporate structure because if you look at other peers they're all pretty much structured with a holding company and operational legal entities underneath the holding company. This kind of corporate structure certainly is more agile, more flexible and lends itself to more easily address any cooperation idea that might arise.

**Matt Lofting, Nomura**

Hi guys, good afternoon, two quick questions please. Firstly I just wondered on the authorisation of the Romanian wind farm recently what the next steps are there and what the possible timing and CAPEX outlay could be there longer term?

And secondly if you had any update around the cooperation discussions with Rosneft? Thanks

**Corrado Costanzo**

Quickly on the Romania wind farm this authorisation is for 100 megawatts and we are working on very quickly upgrading it to 120 megawatts. In principle we do not intend to build this wind farm alone and to put the whole investment on our balance sheet. The primary idea is to make this an equity investment with a partner. In the end our intended participation is still to be determined. We



are currently in talks with a number of counterparts but as you well know these talks usually take quite a long time to finalise. But the basic idea, I'm not saying it's a firm decision, but the base case for us is not to put this thing on our balance sheet. Dario.

**Dario Scaffardi**

On Rosneft there's really not very much to say in the sense that we have started commercial negotiations in the sense that Rosneft is becoming the most important by far producer of Russian crude oil and Russian crude oil is of course of interest to us. So we are talking with them about what opportunities there might be between SARAS and a giant like Rosneft.

**Paolo Citi, Intermonte**

Good afternoon. Just two quick questions. The first one is on your wind park in Sardinia I'd like to understand if you're satisfied or not with the current results, if there could be room for an operational efficiency increase or add additional capacity going forward?

The second question is on the CO2 issue. In these recent days there were a lot of proposals by the European Commission in order to, certain worries utilise the CO2 crisis. I'd like to understand exactly what is your position on this front because on the Sarlux plant I think you are completely covered while I'd like to better understand your position as far as the Sarroch refinery is concerned as starting from next year there won't be any total free allowances?

**Corrado Costanzo**

Well about the Ulassai wind farm yes there is room for expansion, increasing operational performance with wind farms is not easy so we'll not promise anything there. There is room for expanding capacity nearby and we are working on that. And also the legal framework is changing now in Sardinia because it was challenged by certain developers, including ourselves, and the end result of this challenge was positive for the developers. So we're in a bit of a limbo in Sardinia from a legal environment standpoint but yes we are actively trying to expand this wind farm which has been very successful nearby and there's already some framework agreements with a nearby town.

Regarding CO2 in respect of the CIP6/92 and the Sarlux plant yes we must confirm one more time we are totally insulated. We are being reimbursed 100%.

**Dario Scaffardi**

I'm not updated at the moment on the recent developments on CO2 allocations for refineries. To the best of my knowledge they are still under discussion between the various industry boards and the European Commission but we expect these to be relatively modest. If you wish maybe Massimo in the next couple of days can put you in contact with our colleagues who will be able to give you some more detailed information but from what I know at the moment there is nothing that has been firmly set yet for next year.



**Matt Lofting**

Just one follow up question I wonder if you could just give us an update around the progress on possible drilling onshore and offshore Sardinia. I was just wondering what the progress had been there over the last few months. Thanks.

**Dario Scaffardi**

Thank you. Unfortunately not much progress. I mean we're still in the permitting phase so we are filling out the rather long procedure about asking for environmental authorisation from basically the state of Sardinia so we are still in that process which is taking a little bit more time than what we initially anticipated. So nothing new there sorry.

**Closing Comments**

**Massimo Vacca**

Okay well then ladies and gentlemen I would like to thank you for your attention this evening and we look forward to talking to you on the next conference call. We wish you a nice afternoon. Goodbye and thanks.