



# **Third Quarter 2011 Results**

11 November 2011

## **Welcome**

**Massimo Vacca**

**Head of Investor Relations**

Thank you. Good afternoon ladies and gentlemen. Thank you for joining us today for the conference call on SARAS Third Quarter and nine months 2011 Results. We trust all of you received the copy of the analyst presentation that we will discuss today; however, in case you don't have it yet, you can download it from our website.

Our agenda today will be the usual one. Mr Dario Scaffardi, General Manager, will start 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 a detailed review of the results for each business segment and then he will then discuss group financials. Afterwards back to Mr Scaffardi for the market outlook and the group strategy and finally we will take your questions. Dario please you may start.

## **2011 Overview**

**Dario Scaffardi**

**General Manager, SARAS**

### **I. Highlights**

Thank you Massimo. Good afternoon thank you for joining us today. SARAS has had a reasonably good quarter with a positive EBITDA of €2.4m and in particular we would like to point out that the refining sector is almost at breakeven once we consider the hedging gains and Corrado will give a little bit more detail in this respect.

We are extremely satisfied with the way our optimisation programme is proceeding, our programme called Focus. We are achieving encouraging results, particularly in the area of cost cutting, rationalisation and operational improvements. Also I would like to point out that the net financial position of the group is stable at €12m notwithstanding the difficult macro environment.



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In terms of the overall oil market I would say that the third quarter is a transitional period. We have seen the refining margin benchmark improve from -1.8 to -0.6 from Q2 to Q3 and I think we should look a little bit more on how this margin has been made because this is made up of a quarter in which July and August has started showing some encouraging signs of improvement, the benchmark has moved from a -0.7 to a +0.9 in August and came down sharply in September to -2 and has subsequently improved by \$1½ in October and for the first part of November.

The setback in September has been due mainly to some temporary factors, in particular there have been maintenance problems in the export facilities of Azeri crude facilities in Turkey which is key to supplying the Mediterranean market with sweets grades since Libya was no longer available during the quarter so this has pushed up market premiums for that type of grade by \$2 or \$3 thus squeezing the margin.

Since then the situation has started reversing and in particular with also the situation in Libya which has improved very significantly we are seeing production which is resuming at a much more robust level than the one that was expected just a couple of months ago. We, as a group, have already been able to purchase various cargoes of Libyan crude from the newly formed Libyan company which has succeeded the previous company but also from other international operators that were operating in Libya and have resumed business.

In particular if you look at the margin and Corrado will give much more detail on this, our SARAS margin here is reported as 0.9 on the graph but actually if we sum the hedging gains this should read as 2.3, so the overall side margin would be a quite respectable 6.7.

I would pass on to Corrado who will be able to explain in detail what the various sectors have done and then we'll talk a little bit more about the market towards the end of the call.

### **Corrado Costanzo**

**CFO, SARAS**

#### **I. Segment Reviews**

##### **1. Refining**

Thank you Dario. Let's move on to the refining segment. First of all I'd like to point out that the operational performance was very good during the quarter and the throughput stood around 3.5 million tonnes vis-à-vis roughly 3.1 million tonnes in Q2, basically Q2 was a heavy maintenance quarter but everything was back on track and fully up and running during Q3 and we will also see the operational improvements that we have been working on during the past year are starting to materialise in the form of higher profitability.

Then to get to that point, well let me also point out that however in terms of profitability we still suffered from the absence of certainly Libyan crudes, primarily Bu Attifel. So having said that let's look at the numbers. The EBITDA for the period was minus €3.5m however I am sure that most of you are familiar with the fact that we are now running an extensive hedging programme in an attempt to stabilise the company's earnings and therefore we continue to strongly suggest that if



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you take into account the result of realised foreign exchange and all derivatives, gains or losses, during Q3 this net result was €4.6m positive, therefore €33.5 negative becomes about €m negative which is, as Dario was saying, close to EBITDA breakeven that given the very harsh scenario, given the absence of Libyan crudes we believe is a quite impressive result.

In particular if we look at margins the EMC benchmark margin was \$0.6 negative, the benchmark margin, again you might remember that it's a margin for the average refinery in the Med but the SARAS margin, after taking into account the gains on derivatives and on the hedging policy was \$2.3 positive. Last quarter the same calculations would take us around \$1 per barrel negative. The market conditions were even worse and also derivatives were negative in that particular quarter.

So there is a very sizeable difference, \$3.3 quarter on quarter. Of that \$1.8 are due to a more favourable market scenario, the difference in the EMC benchmark and to a lower impact from maintenance activities. However, we also have about \$1.5 per barrel which are due in a sizeable part to improved operational effectiveness which is a consequence of all the actions that we're taking as a result of our Focus operational improvement programme.

So we are overall quite pleased and before we move onto the next page I'd like to point out that the \$2.3 per barrel margin is after variable costs.

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

Taking a look at the Production and Crude Oil Slate as usual we believe that longer periods make more sense so if we look at nine months here what we see is that the crude slate obviously used less extra sweet crudes, again the Libyan crudes not being there but anyway we still had very good results in terms of middle distillates yield which stood at 52.8% for the nine months vis-à-vis 52.4 for the whole year last year. So overall we were able to cope although we must admit that the profitability was somewhat impacted by the absence of these crudes.

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

Fixed costs, as Dario was saying, is an area where we were quite satisfied about the first results. We never gave you any particular guidance or numbers. It is a difficult task, many of these costs are arguably not easy to cut, however, we now have established about €14m of savings vis-à-vis the same period of last year and we're looking at about €20m of savings year on year and also we believe that we're going to have further savings for next year. So as we said when we started the Focus programme we were looking back several years towards the €20m fixed costs per year number which is something that we were used to seeing in 2006, 2007, in spite of inflation and everything else.

Variable costs usually we don't comment substantially on those. First of all they are included in the margin calculation, secondly they are also impacted heavily by the \$ exchange rate.



## II. Power Generation

So I move onto the next segment Power Generation and here again let's give the IFRS numbers which don't help very much, so let's focus on the Italian GAAP EBITDA numbers, back on track, this is the only comment after the very heavy maintenance during Q2 the ten year general turnaround. So we're back on track as I said €36.6m EBITDA.

Here it makes sense to look at the same quarter of last year so Q3 of 2010 the EBITDA was 33.8 so slightly higher this year also as a consequence of operational performance and slightly higher prices so slightly higher power tariff. As you might remember we still enjoy the CIP6 tariff without the incentive component but anyway it is a regulated tariff with a look back calculation mechanism of nine months. So the tariff is now picking up the rise in oil prices that occurred during the first part of the year.

### Fixed and variable costs

One quick look at fixed costs of this division also, nine months ended at €68m which means roughly 90 something million Euros for the end of the year. So again another approximately €10m savings in terms of fixed costs there too. So again we are very pleased with the first results of the Focus Programme.

## III. Marketing

Let's now change subject - Marketing. Marketing the comparable results for this quarter do not mean much because unfortunately the LIFO methodology here since the division is smallish compared to Refining and Power can be heavily influenced by relatively small changes in the inventory levels so we have surprisingly good numbers last quarter and to an extent a little bit of a surprise this quarter also but negative. So those are in part only linked to the fact that inventory levels were first diminished and then we went back to the previous levels. So it makes sense in this particular case to look at the nine months.

Comparable EBITDA for the whole division was €28.2m during the first nine months of 2011 vis-à-vis €19.4m. So an impressive about 50% higher EBITDA which is very pleasing considering the overall economic environment. Most of these improvements come from Italy where we increased quantities and to an extent also margins. Things look more mixed in Spain. We cut on our opportunistic sales and took a defensive stance on margins but certainly over there things are a little bit more challenging. Overall we're very pleased.

## IV. Wind

Wind instead is disappointing this year it's the worst year for very simple reasons, even if we upgraded our wind farm in Ulassai unfortunately it's a very, very particular year from a meteorological standpoint and very little wind and disappointing production although power tariffs and green certificate prices are more or less in line with last year or slightly higher. So that's about it for the different divisions.



## V. Financial Overview

### 1. Key Income Statement Figures

I would like to comment on a couple of other pages. Page 16, I think that it is worthwhile to spend a few words on why there is a negative difference between the net after tax result for Q3 which is €2m negative, the reported net income, a loss obviously, and the adjusted net income which is 24.0. Well this is largely due to the fact that the reported number includes the fair value of derivative instruments after tax. Instead the methodologies that we use for determining the adjusted net income does not take into account any fair value, positive or negative, after tax and we have been doing that quarter after quarter for years and we obviously did not want to change the methodology for this particular quarter and that explains why there is this large negative difference. There are €6.9m worth of after tax positive fair value of derivative instruments and therefore if you take those away you're going to end up with a loss and that's about it.

### 2. Key Cashflow Figures & CAPEX

Then one quick word on CAPEX. It is for the nine months €74m, we gave a guidance of €120m, we're probably more around €100m for the year. And I think at this point we can move onto Outlook and Strategy.

## Outlook and Strategy

**Dario Scaffardi**

### I. Outlook & Strategy

#### 1. 2011 Maintenance Schedule

Thanks Corrado. Our usual slide on maintenance. Maintenance in 2011 has had no major surprises, things have gone on schedule. We are not in a position yet to publish a 2012 schedule because we are currently reviewing some items due to the changes that we've seen in the markets so according to the way and the timing in which the Libyan situation is going to develop we might adjust our schedules accordingly so we're not quite ready although the estimated EBITDA reduction for usual scheduled maintenance which happens every year should be in the same range as 2011 and possibly we will have some extra maintenance shut downs of units during this period but it's something that will still need to be decided.

One very positive development as Corrado pointed out but I think that we should stress it further is that being the Libyan crisis, at least from our point of view, at least basically over and resolving this has a twofold effect, one on the overall market so this is less pressure on the premiums for sweet grades, so the premiums of sweet grade is coming down significantly. Let me just remember that prior to the Libyan crisis an average premium for sweet grades which was in the range of about \$2, post Libyan crisis this has gone in the range of \$4 to \$5. It has come down quite significantly,



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not yet back to the level of about \$2 but we're getting there and right now we are at about \$3 and this has an overall beneficial effect on the overall margin. Specifically for SARAS during our last call I think that we gave an estimate of a specific penalisation for SARAS due to some particular grades and also to the logistics that we enjoy with Libya of about \$½ to \$1 a barrel. So we expect, if not all of this penalisation, a big part of this penalisation in Q4 to disappear. So this is quite a positive outlook for the remainder of the year and for the beginning of next year.

If we go to the next page we are concentrating as a company very strongly on our optimisation focus which already Corrado mentioned about and gave some details on the economic results we have been obtaining. Actually this programme was supposed to have been implemented in various phases, we had a third phase scheduled for 2012 which has actually been anticipated to this summer in which we have changed quite significantly our way of operating in the sense that we have given much more impulse to the supply and trading part of our company since the volatility of the market is such that it's absolutely necessary to be able to try to capitalise on any opportunities that the market might present since the volatility of the market itself is quite higher than the actual margins by a factor four or five, at least margins have been just using the EMC benchmark either at slightly negative or slightly positive territory and let's say that with the premium that we add to the EMC we're in the range of something that is in between \$2 - \$3 volatility can be easily in the range of \$8 - \$10. So clearly much more focus must be on the issue of volatility.

From all the optimisations that we hope to achieve in this area over a period of two to three years we see a potential of at least €50m which again should be achievable in a timeframe of about two to three years.

Our organisational structure has been changed, has been further simplified, to make decisions faster and quicker and this is putting extra strain on our refining system because we are trying to react much more quickly to the changes in the market but the system is coping quite well with this. We have had some significant addition of respected professionals of the industry which have joined our team so we are concentrating on all areas, as Corrado has already mentioned, of cost reduction, rationalisation and energy efficiency. The area that is proving a little bit more challenging is energy efficiency because we were already at a relatively high level there so obtaining further improvement is proving somewhat more complex than what we anticipated but we're putting extra effort in this as well.

We have given further impulse to our gas exploration project. The findings that we have in this area are extremely encouraging so we are right now in the permitting phase and in the awarding phase to contractors to actually start drilling. This will presumably take place hopefully in the first or second quarter of next year and it's solely dependent on how long it will take to gather all the permits and there are some very, very encouraging results.

In terms of the market well I think there are some encouraging signs for refiners. First of all you've probably noticed that after almost five years the market has switched from a situation of deep contango to a situation of backwardation. Backwardation has been the norm in the 15 years prior, I mean from 1990 to 2005 basically the market has always been in backwardation and this is, in my personal opinion, a more normal structure for the market and is also more encouraging for a refinery because basically the situation that we had in the years before of strong contango created free opportunities to traders to stock product, buy product, stock it and through forward selling





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basically secure a profit that had the end effect of depressing margins for refiners that one way or the other are forced to sell on the market. Storage is of course an option for ourselves but up to a point clearly, there is just so much storage that we have and also financial capability of taking on one's shoulders too much storage. This situation is more helpful for us basically because it means that the market is being mopped up of extra barrels and you can see this also in the storages overall quantity that is available which is declining. So we are experiencing a situation in the market in which spikes due to the fact that there is a shortage of gasoline or a shortage of diesel are more frequent and these are exactly the type of opportunities that we can capitalise on.

Also there has been a lot of talk in the last months and a lot of papers written about the crisis of refining and the fact that the European refining system is undergoing a difficult situation. I think I've always expressed my opinion on the fact that I've struggled to agree on this point. Europe uses something like 14 million barrels a day of oil but has refining capacity for something like 12½ so it's sort of difficult to understand why Europe should have a big problem with refining and nobody else. Clearly this is due to the fact that there are imbalances in the market due to the fact that we are not all playing on the same field. There is a growing awareness of this fact from, first of all, the industry associations but also political bodies which are a little bit more sensible to the fact that all the crisis or all the overcapacity that exists on world refining capacity is sort of being short circuited into the European system and all the other systems seem to be shielded from this single fact and they're shielded by a variety of reasons.

I would just like to point out some economics. Shipping from an island refinery in the Mediterranean to mainland southern Europe costs about \$1 a barrel. Shipping from the Indian Ocean today in a depressed, very depressed, shipping market costs something between \$5 to \$6 per barrel. So Corrado showed you our structure of fixed and variable cost which in total are roughly \$6 so it's sort of difficult and one struggles to understand how exactly the economics of shipping oil from the other side of the world can make sense if we are all playing by the same rules.

Since it's not the case I would expect that we will be able to make our voice heard and this sort of situation, particularly with the market that is helping us in the fact that there is no longer this protracted contango situation which incentivised these sort of play I think we are going to see next year particularly a more balanced field of play.

Thank you very much for your attention and we will be pleased to answer any questions you might have.

## Questions and Answers

### **Lydia Rainforth, Barclays Capital**

Thank you good afternoon gentlemen. A couple of questions. Firstly on Project Focus and the change towards the commercial side. I know you talked of €50m over the three years how quickly do you think you can actually get that round so it sounds like some of the changes you're making are actually immediate and I'm wondering what sort of examples you were doing for this year.



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And then secondly in terms of that commerciality side is the idea that you would start to play with your inventory levels a little bit more and you talked about the contango and backwardation do you see more opportunity in being able to trade around that?

### **Dario Scaffardi**

Thank you Lydia for your question. Well in terms of the timeframe let's say that we would expect to be able to achieve 30 - 40% next year and hopefully almost the full level by 2013. What you are saying is absolutely correct clearly managing the inventory, since we have a relatively large inventory let's say that our inventory is in the range between eight to 10 million barrels more or less, managing the inventory with oil at \$100 a barrel clearly makes a lot of sense and that is one of the areas on which we are concentrating so managing the backwardation, managing the contango is absolutely crucial, managing purchases and sales, the same.

Another area of optimisation is taking opportunities since thanks also to Libyan crisis which as usual a crisis can bring positive things it has actually taught us quite a lot because it has forced us to be more proactive in the choice of crudes so we have rekindled our knowledge of particularly the West African and Central American market for crude oils which clearly having Libya right in front of us at 24 hours sailing time sort of promoted a certain amount of let me say laziness, it was a lot easier to buy crude from Libya than from Angola, for instance, which instead of 24 hours is 24 days or something like that but the crisis has forced us to swim farther away from the shore. We've learned quite a lot of things and we've been able to find more opportunities in the market so crude reselling for instance has become a little bit more important and we have become more proactive in this. We have also become more proactive in our marketing activities. As Corrado showed we are seeing some very interesting results in Italy. We have grown both in terms of volume and in terms of margin. Spain unfortunately is a bit disappointing in terms of volumes but we have had improvements in terms of margins. So once we are in a position to consolidate this situation we plan on growing in terms of volumes there as well.

And another very, very important thing is actually in the choice of crudes, of the runs and so forth.

### **Lydia Rainforth**

Thank you very much.

### **Dan Ekstein, UBS**

Good afternoon everyone. I've got a couple of questions. Firstly you talk about the sub-optimal operations due to the loss of Libyan crudes and I think you mentioned the negative impact of €m. I'm just trying to get down to the specifics of that. Is that €m related solely to the sort of optimisation on the product slate or does that also include the incremental costs of crude acquisition that you've suffered as a result and I wonder if you could split that out for me if possible.

And then secondly Dario you were talking about an unlevel playing field and you made several hints are you coming down to the need for some kind of border adjustment mechanism here? I





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wonder if you could be a bit more specific about how you see this being equalised going forward and whether you really believe this is the only cause of the poor margins in Europe at the moment.

And then next year you talked about the structure of the market how do you see capacity additions playing out next year please?.

### **Dario Scaffardi**

Well clearly there is a lot of capacity addition which is being added worldwide and of course there is no doubt that there is a global overcapacity on refining although this overcapacity is frankly overstated because as in any system you need definitely more capacity than what the expected consumption is. So if we have an overall oil production of today which is approaching 90 million barrels a day and is expected to grow by 1% or 2% a year or whatever you need a refining capacity that in my opinion is at least 120% of that number, to the very least, just to be safe. So if we have in place a refining capacity of 110 million barrels I would say that that is absolutely normal and optimal and something which is reasonable to have in the same way you have excess electricity production. I mean I think no country has electricity capacity which is not 110 and if it doesn't have that then it has a problem clearly because you're not able to manage averages, so refineries tend to run, a good refining system tends to run at 92, 93, 94% of nominal capacity so I mean you just work out the math the excess is not too large.

What I contest is the fact that if worldwide we have excess refining capacity why is this a problem only for Europe since Europe is short on products? So actually if one looks at it from an objective point of view Europe is the place to be to refine because it is short of diesel and the European system is not able to provide all the diesel. So where is the problem? Actually European refineries would have to scale down production because maybe they have a little bit of a problem on gasoline and that is a structural problem. So if anything Europe becomes even shorter on diesel and to balance itself we would have to rely on a certain amount of imports as has been. The problem is that all the refining capacity which is being added is refining capacity that one way or another does not play according to the same rules as the European refining capacity so we don't have the same environmental rules, we don't have the same labour rules and we do not enjoy any sort of tax holiday or subsidy or anything else. So we're not playing by the same rules. So if we take this into account then all of a sudden Europe has a problem that everybody else does not which is in my opinion counterintuitive and not logic.

Now whether we are able to go in to find a solution for this or not is slightly another matter but I don't think the solution is going to be just for the European refining industry to suicide itself in order to balance the world refining system I just don't think this is an outcome that is reasonable, not just because I don't want to suicide our company first of all, obviously, but I don't think this would be in the best interest of the European consumer.

We could just look at what happened with the steel industry over the 70s and the 80s this capacity has been moved to Europe and to other countries basically and today we are importing these materials not at a lower price so there is absolutely no benefit in the long term for the European citizen, for the European consumer. So I feel strongly about this of course and I'm trying to make our voice heard in all the various areas where this can be done.



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Sorry but you were asking something also about, I got carried away, about Libya I think Corrado can answer.

### **Corrado Costanzo**

Yeah the €3m is a rough calculation of the overall impact of the absence of certain, not all, Libyan crudes and it basically corresponds to about half a dollar a barrel at today's exchange rate so it should be taken as a rule of thumb more than an exact number.

### **Dan Ekstein**

No doubt that would include the feed stock and the product slate side of the equation?

### **Corrado Costanzo**

Basically yes but as I said it's a broad guidance. I mean there's no accounting number that splits precisely every effect.

### **Dan Ekstein**

Okay thanks have a good weekend everyone.

### **Hootan Yazhari Bank of America, Merrill Lynch**

Good afternoon gentlemen I was just wondering on two counts I wouldn't mind just getting your views on when you feel from your discussions with your Libyan counterparts when you feel you can start moving more towards normalised levels of Libyan crudes? I know it's hard to assess right now.

And then the second question I have is really regarding further projects you might be looking at, at the moment, aside from what you've just discussed in Project Focus? In particular with regards to areas in energy savings and what you might be looking there to further save on energy costs at your refineries? Thank you.

### **Dario Scaffardi**

Well in terms of Libya the situation in November from our point of view since we are interested mainly in certain specific types of crude has shown some definite improvement. I think that we have purchased from Libya for November either two, or four cargoes they're telling me, okay I was at two or three instead of already four, so from our point of view it has already returned to normal. Also because we have been relatively lucky because the first crude to come back on stream is the type of crude that we are most interested basically the paraffinic grades, while I understand that they have a little bit more of a challenge on the normal sweet grade such as Es Sider and so forth and which the installations have been slightly more damaged. The crudes that we are interested in come mainly from the eastern part of the country and therefore they have been the first to come back on stream. So from our point of view the situation if not completely normal is relatively normal. Of course they are also restructuring the operation, their offices, they have some



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communication difficulties, some travel difficulties but all things that are being overcome quickly and effectively.

In terms of energy savings I think that it might be a slight mistake that we have made at the beginning of our project is thinking that we had some relatively simple solutions to the problem so that all we needed to do was fix some minor issues and we could obtain important energy savings. Instead we've realised that we need to make probably some investments in this respect. We probably need to reengineer certain areas so we are approaching the matter from a little bit more of a technical standpoint looking at the process, looking at the engineering and seeing exactly what area. So we probably need to make some small investments in order to obtain some more effective and meaningful results.

### **Corrado Costanzo**

On the other hand, Hootan, I'd like to insist on the fact that we are by far exceeding our own expectations in the area of cost reduction so sometimes even if you look at your own operations in depth it's hard to figure out and invent exactly how things are going to be but the refreshing thing is that the results are there and more are expected to come next year. On balance we still have a plus sign vis-à-vis our own expectations in terms of the yields of protocols so we're seeing tens of millions of very quick cost cuttings which can be replicated year after year and then also when those minor investments that Dario was talking about will come on stream then we're going to see also the energy savings. So we're quite pleased about the outcome overall.

### **Hootan Yazhari**

Understood. Just as a follow up so going back to the Libyan issue you said you've taken four cargoes is this the run rate that you would normally expect and hence should we expect to see the circa 50 cents per barrel uplift coming through in Q4 or is that something that you expect to ring through throughout next year?

### **Dario Scaffardi**

About four, I mean we have had periods in our history in which we have taken quite more of Libyan crude but some grades are easily substituted by other grades so they are not an issue and they have been substituted. I would say that accounting for what we consider the more strategic grades four is about the right number. So I would expect the 50 cents, if not already in November, at least in the second part of November because these cargoes are coming in through the month, they haven't started all on the 1<sup>st</sup> November. So the full impact in November is probably not going to be there but certainly in December.

### **Hootan Yazhari**

Understood thank you very much.

### **Ioanna Exarchou, Citigroup**

Hello everyone. First of all I was wondering if you could touch upon the €190m bullet line that is due to be reimbursed in June next year? I know it's still a few months ahead but are you in



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discussions currently with the financiers about this topic and what are your general thoughts on that?

My second question is on North African demand and I was wondering whether you're seeing North Africa and Libya in particular as a growth export market for yourselves post the Arab Spring and the revolution in that region?

### **Corrado Costanzo**

The easy one first or easier maybe. Let's start from the point that we have ongoing discussions with the bankers that participated in this syndicated bullet line of credit which has also a relationship type of bankers too and so they fund the company in a number of ways. So we have ongoing discussions which however for the time being have not been specifically focused on this line of credit although we do not anticipate any particular difficulty. To tell you the truth we're not rushing because there is another five months roughly and you might have heard that there's a few problems in this country so maybe this is not the best time to finalise these discussions in advance. So we're going to wait a little longer. Things will certainly get better for Italy as a whole and also for all the fallout in terms of credit availability and spreads and margins.

### **Dario Scaffardi**

On demand in North Africa yes these have been, over the years, the sort of market that we're not widely known but an important market nonetheless. We do supply, for instance, gasoline to Algeria and we have always supplied important amounts of gasoline to Libya and this is resuming now and we expect it to pick up. North Africa is an important market. Also the Middle East is, or was, an important market, for instance, Syria had become at a certain stage quite a large importer of finished product, that of course due to the embargo from Europe, at least for the time being, stopped but we expect it sooner or later to resume once, sooner or later, the political situation will be resolved. So these are all important markets.

### **Corrado Costanzo**

I'd also like to add here just to put things more into context that we're not rushing because we have the luxury not to rush because as you might have noticed our overall debt levels are firmly under control. There's a combination of different factors, working capital management, but also cost cutting, very firm control of CAPEX and a bunch of other things, so we still have a wide availability of unused lines of credit and this is why we have the luxury not to rush.

### **Sergio Molisani, Unicredit**

Good afternoon to everybody, two questions if I may. The first one on the supply and demand balance. Dario you are clearly referring to the competition and the damping action carried out from China and India, can you give us more colour on this, would this account for the test of something like 10% coming from China and India versus the price proposed by the refineries in the Mediterranean area? And then how does this project actually compete with you in terms of environmental requirements? In other words are they used for branding or are they a close substitute for your products?



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And the second question is on backwardation is this something related to the current credit crunch and the growing cost of debt and does this encourage building of inventories or do you see any major other factors explaining these trends now? Thank you very much.

### **Dario Scaffardi**

Hello Sergio, thank you. Well on the backwardation in my opinion there might be I mean but I just believe that the situation of a market which is structurally in contango is not a sustainable situation, notwithstanding the fact it has been in that way for basically five years. A contango market means that consistently somebody believes that the forward will be higher than the present. So there is always a positive carryover and it's a mass way of printing money. This sort of thing, sooner or later it's like a bubble that needs to explode, it's not normal. The normal situation of the market is backwardation.

This is more of a sort of philosophical view from somebody who's been on the market for many years but contango is not normal. In the past you would have contango for a couple of months due to a variety of situations. Everybody has always imagined that the market would be able to oversupply itself so this was the reason why prompt was higher than forward.

Then in 2005 the idea came that the market would always be short that there would not be enough oil on the market, period, so this sent everybody into a buying spree and the forward curve has been consistently leveraged upwards but this really is not normal because contango is a way to print money. You buy today, store it and sell it tomorrow. It is not normal. So I don't think although I don't have the data to give a meaningful opinion whether it's related to credit crunch or not. Possibly. I mean of course one of the reasons why contango was there was that credit was so low that clearly it was very easy. I mean the threshold of being able to store oil was minimal, paying very little. So definitely it must have some impact on this.

Talking instead about the competition well the competition being an open market what you see is you see finished barrels because the oil that they produce in India or China is absolutely up to spec according to European specifications and particularly today the main export market is no longer China, China is actually importing now diesel and the main exporter has changed from China to the US because the US is enjoying a price of oil which is much lower than the price that we are paying. A large part of US refineries which are based in the Gulf Coast and in the Mid West buy their crude based on WTI and you all know that WTI has been at \$25 discount, today it's more like \$16, \$17, but still at a huge discount to Brent, while historically it was always at a premium to Brent so this gives a huge incentive to run crude in the US, produce diesel and ship it over to a market which is short, compete according to the basically in Europe we have, the way the oil price is formed in Europe is through an auction system which is run by Platts. So every day the operators are able to auction their barrels and this can either drive the price up or down because it's based on differentials to the futures market.

So with this system anybody can bid into this open system and drive prices up or down by selling their barrels. So the competition we have is really our barrels which are being displaced by import barrels. It's very difficult to understand where the economics of this is because as I mentioned freight is expensive, notwithstanding the fact that current freight levels are at historical lows, still shipping a vessel from China for instance to Europe is a huge cost, a little bit less shipping it from



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the US Gulf to Europe but still fairly expensive. So in order to rebalance the arbitrage there must be some other factors which I'm not able to see. It's not some sort of hidden subsidy or other advantages that European refineries don't have. European refiners have CO2 costs and with the ETS scheme that is proposed by Europe in 2013 there will be a further impact. It has costs related to the addition of biofuels which cost. It has costs related to all our environmental rules that are expensive of course and that others either don't have or have to a much lesser degree. I think this is a big problem and I think this problem is going to be relatively solved sooner or later because it's not a situation which can go on forever.

### **Sergio Molisani**

Very useful thank you very much.

## **Closing Comments**

### **Massimo Vacca**

Well in this case thank you very much ladies and gentlemen for your attention this evening and we wish you a nice evening and we will speak on the occasion of the next call. Thank you. Goodbye.