SARAS
Second Quarter 2008 Results
2008

Welcome

Marco Schiavetti

IR Manager, SARAS

Good afternoon to everyone and welcome to our second quarter and half year 2008 earnings call. Together with me are Dario Scaffardi, General Manager, and Corrado Costanzo, Chief Financial Officer (CFO). We have the usual agenda today. Dario Scaffardi will start with a qick introduction; Corrado Costanzo will then go through our various business segments. We will then go back to Dario for strategy and outlook.

Highlights

Dario Scaffardi

General Manager, SARAS

Thank you, Marco. Ladies and gentlemen, welcome to our conference call. We are pleased to announce a record quarter, which shows an increase in earnings before interest, tax, depreciation and amortisation (EBITDA) and Group adjusted net income of over 30% versus the previous quarter. This is due to a very strong refining margin, reliable and consistent operations over time, and our marketing capability. This has occurred notwithstanding a very difficult macro-environment, which has seen extreme price volatility, record prices of crude and a record value of the euro versus the dollar.

I would like to highlight that SARAS has been delivering over time on its promises in terms of its investment plan. For the last two years, we have presented and updated our programmes for increasing conversion capacity and we have delivered on them. We are quite confident in terms of our positive view of the refining market, in particular the competitive advantage that arises from having a complex and diesel-oriented refinery. On 24 June, we presented to the markets our industrial plan for the next three years, the main focus of which was organic growth in our key asset, which is the Sarroch refinery, and the plan is basically centred on increasing diesel production at the expense of fuel oil.

This last quarter has seen record values in the diesel crack and likely record negative values of the gasoline crack – quite the opposite to what happened in the same quarter of last year, where margins were sustained by very high gasoline crack and a normal diesel crack; this notwithstanding the fact that gasoline has strong demand in the Middle East and Asia and, as a matter of fact, we have no problem selling this product, although there is decreased demand in North America. Our margin has registered a record: our overall refining margin was $11.3 per barrel, with $7 on the Energy Market Consultants (EMC) benchmark, due to the strong exposure that we have to the diesel margin. I would now like to hand over to Corrado, who will go into greater detail around the various segments.

Segment Reviews and Financial Overview

Corrado Costanzo

CFO, SARAS

I. Segment Reviews

1. Refining

a. Runs, margin and EBITDA

Thank you, Dario. Let us start as usual with refining. We saw very strong margins, driven by diesel cracks. However, the weak dollar played a role in euro-dominated EBITDA terms. The results are comparable on a year-on-year basis. I would like to stress that our comparable numbers are based on last in, first out (LIFO), which is audited twice a year, so these are entirely reliable. The runs were up 11% in Q2 this year compared to last year, because the maintenance that was performed this year involved conversion units rather than distillation units, so the premium over the benchmark was a record $7.1 per barrel. This was possible because the impact of maintenance was minimised. I would like to remind you of our guidance for Q2 of about a $30 million loss due to a lower conversion capacity. This was due to by brilliant optimisation, using feed stocks and lighter crudes to maximise middle distillate production, despite the turnaround of certain key units.

b. Yields

Switching to our yields, we delivered an impressive 54% middle distillate yield, mainly at the expense of lower naphtha and gasoline when compared to last year's figures. The crude slate shows an increase in sweet Caspian crudes, although the average crude API was unchanged because all classes of crudes were characterised by lower API.

c. Fixed and variable costs

- Variable costs are in line with our original guidance and, in any case, their effect is fully reflected in the EMC benchmark.

- Switching to fixed costs, we saw higher costs for H1 2008 compared to last year, mainly because most of the planned maintenance performed this year was not capitalised, unlike last year. However, our guidance for fixed costs is confirmed at €200-210 million for the full year.

2. Power Generation

a. Production

The performance of the integrated gasification combined cycle (IGCC) unit was in line with expectations, and the higher production was due to the fact that, this year, there was no major maintenance in Q2. The power tariff was also up, due to obvious reasons: higher crude oil prices. We are comparing pears with pears here since last year already included the new indexation mechanism for the power tariff.

I would like to stress that CO_2 reimbursement, a particularly important point, was finally resolved in Q2, following the announcement by the Italian energy authority in June, with a specific provision and, therefore, that is a matter that has been resolved at this point.

3. Marketing

In terms of marketing, we are talking here about different orders of magnitude. However, the performance of our marketing segment was impressive. Despite somewhat declining demand in Italy and Spain, sales volumes increased 5%, and margins were up too. We reshuffled the mix of sales channels, with lower sales to commercial operators and higher sales to more profitable sales channels such as unbranded service stations.

4. Wind

At the end of June, we acquired the 30% minority interest of Babcock & Brown for about €30 million. This also implies that, from now on, this unit will be consolidated on a full basis. However, for H1 2008, there is still no impact on EBITDA, although the €60 million debt that is on the wind company balance sheet is fully consolidated in the H1 numbers. The performance was good from a production standpoint, but there is still an ongoing problem with the valuation of green certificates, which continues to fall. Therefore, we were forced to further write down the green certificates, which have decreased substantially from last year from €120 to €70 and, possibly, today, €60 per megawatt hour (MWh). Clearly, this is not good news; nonetheless, it is a fact.

II. Financial Overview

1. Key Income Statement Figures

We saw lower interest expenses this quarter and certain small differences related to the use of derivative instruments on a quarter-on-quarter basis.

2. Changes in Taxation

There has been a lot of debate about the so-called 'Robin Hood Tax'. Clearly, the 5.5% tax hike on our income is already included in the H1 numbers. However, quite ironically, there is a very large one-off gain in our official figures that is due to the fact that, based on International Financial Reporting Standards (IFRS) accounting rules, we had to post deferred taxes based on FIFO at the statutory tax rate. Those taxes were never going to be paid, but now the government has decided otherwise, so we have this one-off gain because we clearly wrote off this provision of about €120 million net of about €50 million of one-off taxation at 16%. This is quite a surprising outcome from an accounting statement, but that is the way that it is. The cash flow effect is now estimated, based on 30 June quotes for crude and oil and products, at $50 million. It would be lower today and, by the way, the impact of cash flow is diluted over three years.

On the other hand, we took advantage of an opportunity that was granted by the 2008 budget law, which eliminated accelerated depreciation for tax purposes but, at the same time, gave corporations the opportunity to depreciate one more time whatever was previously subject to accelerated depreciation. This will cost us €32 million and will save us roughly €43 million based on the new statutory tax rate over the next three years. The two measures offset one and another and, therefore, the effect of the Robin Hood Tax is close to nil, with the exception of the ongoing 5.5% surcharge.

3. Key Cash Flow Figures

We saw strong cash flow from operations of €206 million, but with a €162 million negative impact from working capital. Clearly, working capital in this business is difficult to predict on a quarterly basis, so these figures are still somewhat within a range that can be defined as normal. You might see a reversal of that next quarter. As I said before, €60 million are due to the consolidation of the Sardeolica PEU acquisition debt. Capex is basically in line with our guidance.

At this point, I will hand back to Dario for the final remarks.

Outlook and Strategy

Dario Scaffardi

I. Outlook

1. Runs

Our maintenance schedule is unchanged versus previous updates. Between Q1 and Q2, we completed our maintenance on one of the mild hydrocracker units and on the alternation unit on the visbreaker. There are no surprises there. As Corrado mentioned, we have already targeted 7.7 million tonnes of runs, so we are delivering on our programme to increase to refinery runs in 2008 by 700,000 tonnes. We are, therefore, confident of being able to reach the 15.4 mark by year end.

2. Guidance for Refining Margins

At our last quarterly meeting, we introduced new guidance tools to help forecast what premiums to add on to our EMC benchmark. In H1 of the year, we added $6.3 per tonne above the range. We are above the guided range because, on top of the effect that is due mainly to the diesel crack and diesel fuel oil differential, which is the main but not the only driver, we have also been able to acquire other types of crudes and to sell products of a different nature, thereby maximising returns. These have added almost $1 to this base margin.

3. Short-Term Outlook

We expect the diesel crack to remain strong and definitely above its historical levels. There is still strong demand. We expect some support to come in, particularly right after the summer, in September/October, due to the change in specification in Europe. From 1 January, we are going to move from diesel and gasoline products with 50 parts per million (ppm) sulphur to 10 ppm. Already, demand is coming because people need to clean their tanking and logistics systems, so we expect much higher premiums in the last part of the year due to this. No other maintenance is planned, so we expected full refinery runs up the end of the year. There will be a routine slowdown in the IGCC during the last quarter.

II. Strategy

Our overall strategy was already presented on 24 June:

- We are continuing with our plan to buy back up to 10% of our shares in an 18-month period. Up to now, we have bought about 14 million shares.

- Focus is on organic growth. We are going to increase diesel production by about two points over the next three years, adding $2-2.4 per barrel to our refinery margin.

- We are expanding our activities in the marketing segment. Our biodiesel plant in Cartagena is about to enter the commissioning phase and will be up and running by the end of the year. We decided to build a new depot in Spain and there is a renewed focus in this segment to try to target the highest return areas.

Thank you for your attention; we will now be pleased to take your questions.

Questions and Answers

Anish Kapadia, UBS

First, on power generation, I saw your earnings were down in Q2 versus Q1 on an Italian GAAP basis. Could you explain that, and how do you see the progression on an Italian GAAP basis for the rest of the year?

Second, I missed your comments on the wind power division in relation to the tariffs that you are receiving. Could you go over that in a bit more detail?

Corrado Costanzo

In terms of power generation, there is somewhat of a mismatch between the section of the power tariff which is linked to oil and gas prices on the revenue side. On the cost side, the TAR indexation is still linked to the old mechanism, so the tar went up slightly quicker than revenues. That explains why profit shrank marginally.

Green certificates are accounted for based on an estimate value. They are being somewhat earned[?] during the year. There was a very small market, with very low amounts of trades, during most of the year, with most of the activity taking place during the winter, at the end of the year and at the start of the following year. Therefore, you store a large part of your certificates and have to sell them later, which means that, if, in the mean time, green certificates decrease in value, for a number of reasons that would be quite time consuming to explain, the values that you post need to be written down in the following year, which is what we are doing. You could say that the 2007 profits for wind were overstated. We could then have a long conversation about why green certificates are going down, but they are.

Anish Kapadia

Returning to power generation, how do you expect the trend to move over the next few quarters in terms of the tar indexation versus the CIP 6 tariff?

Corrado Costanzo

Tar indexation is somewhat more reactive and the power tariff has an eight-to-12-month lag, which does play a role from an Italian GAAP standpoint. There is, however, a catch-up mechanism, and this is not an infinite process. You might have temporary effects but the two segments do catch up.

Dario Scaffardi

It could also be strongly influenced depending on whether you have a rising or a falling market, so the situation could be inverted if the market began falling consistently. Whether or not this will happen, somebody else will decide.

Anish Kapadia

Based on current crude prices and given the fall that you have had so far this quarter, you would expect somewhat of an up-tick there in the earnings in Q3.

Dario Scaffardi

If the market starts declining, you could expect a compensation of the two effects.

Corrado Costanzo

The mechanics of the new indexation mechanism for the tariff are somewhat cumbersome and include quite a significant time lag. In other words, the tariff always looks back to rather old quotes from 10 months ago. The tar indexation mechanism is, on the other hand, much quicker, so you have a two-month lag on the tar indexation in our case and a 10-12-month lag on the revenue tariff indexation. Eventually, however, aside from future movements, the two do catch up.

Lydia Rainforth, Lehman Brothers

First, the diesel yield was very high this quarter. Was that as high as it could have been or was it affected by the maintenance that you had during the quarter?

Linked to that, is the premium relative to the EMC benchmark down to the volatility in the environment or is it more a locational issue?

Finally, on the cash returns policy, could you remind us of what the criteria are for repurchasing your shares?

Dario Scaffardi

Could you repeat your third question?

Lydia Rainforth

It was on the share repurchase scheme. You have bought back 1.5 million shares so far; is that a run rate that you would expect to continue for the rest of the year?

Dario Scaffardi

On the diesel yield, the visbreaker was down for maintenance for a period, as was one of the mild hydrocrackers, so our diesel yield could have been higher, but that is not the complete answer. Of course, since this maintenance was programmed, we switched the crude programme in order to maximise all the other units. In reality, we were probably able to maintain the diesel yield, but perhaps not with the same economies. If we had the mild hydrocracker and the visbreaker running, we would have used slightly different crudes, of course at greater profit, and presumably we would have made higher returns. The flexibility that we have allows us to change the feedstocks around quite a bit, so although production remains more or less unchanged, the margin on this production is what really changes.

On the EMC benchmark, we were able to capitalise on the location, with the Mediterranean the ideal place to be. There is an abundance of a variety of crude oil, all of very good quality, so we have definitely been able to take advantage of some so-called ‘bargains’. Also, we have played the volatility in an intelligent way and have been able to make strong sales when the market topped. We maintained a policy of purchasing feedstocks for the first time. In this quarter, we purchased more feedstock than usual because we had the maintenance and we wanted to keep throughput at a maximum, so we purchased straight runs and other feedstock in order to maintain production at more or less usual levels.

Corrado Costanzo

In terms of the share buyback, we are off to something of a slow start because of certain technicalities that have now been solved. The pace of the buyback programme is set to accelerate.

Michael Alsford, Morgan Stanley

On the marketing result, I was quite interested to see that the diesel demand in Italy and Spain were still up in Q2. Could you give us some more colour in terms of what you are seeing in Q3 and whether the trend is deteriorating, given the high product prices?

Dario Scaffardi

The numbers that we presented were SARAS' sales. Diesel demand in Spain is up by about 2%. In Italy, demand is slower. There is a very negative impact in Italy on gasoline studies of about 8%, while diesel demand is flat to very slightly positive. Although our marketing division has been able to increase sales, we are talking about a relatively small market share. While we have increased sales in absolute numbers, they are relatively small.

Will Forbes, Credit Suisse

In terms of your updated guidance on the crack versus the refining margin premium, you have been achieving significantly higher than your guidance for the last two quarters. Given that gasoline was very low this quarter, what causes your premiums to be higher than your guidance, and can we expect that guidance [inaudible] and maybe should be extended in the future?

Dario Scaffardi

First of all, as we have tried to explain, the result of the refinery is a complex matter which arises from many different factors. Trying to simplify, the main driver, particularly in this period, has been the diesel fuel oil crack. Therefore, the guidance that we have given is fairly accurate in that range. In addition, in a market that, over a three-month period, has moved by 30% in price, by optimising your crude purchases, both in terms of timings that reflect the base price and in terms of quality, you can achieve a lot of money. This is part of the extra margin that we have been able to achieve. You have to add the fact that we have had, from an operational point of view, a very good quarter. This quarter is probably a record one in terms of runs, notwithstanding the fact that we have had two important plants in maintenance. All of these factors give us an extra $0.70-0.80 on the premium to the EMC benchmark. In a market with the volatility that we are seeing, this is a relatively modest figure.

Kim Fustier, JPMorgan

If I remember correctly, you upgraded your long-term oil price assumption to $80 a barrel earlier this year. Given that we are at $120 currently, when do you next intend to look at your long-term oil price assumption?

Second, on the disadvantaged crudes that you are buying, you just said that this added quite a bit to your realised refining margin, which is obviously quite an important part of the premium that you are realising over the benchmark. Could you give us any guidance going forward on what kind of discounts you can achieve relative to light, sweet crude benchmarks?

Dario Scaffardi

On our crude assumptions, we have never given any long-term price assessments. The only thing that we have presented, which we did during our 24 June investor meeting, is the fact that we have assumed $100 as a long-term price to justify the numbers that we have presented in the investment plan. After that, everyone will use their own figures. We have stated that the returns that we will add over the next three years are based on that assumption, with a diesel crack of $25, a gasoline crack of $4 and a fuel oil crack of $30.

Corrado Costanzo

You might be referring to the $80 which was used for the equalisation of the –

Kim Fustier

Yes, I was referring to the CIP 6 tariff.

Corrado Costanzo

Yes, that is still $80. We update the long-term numbers on a yearly basis, since they need to be discussed fully with our auditors. You will see the next update when we release our full-year accounts in six months' time.

Dario Scaffardi

On discounts to crudes, it is not really possible to give any guidance. Apart from the base case crude oils that we have, we try to take advantage of the opportunities that present themselves on the market. The market is extremely volatile. For instance, we have seen the sour crude marker in the Mediterranaen, which is Urals, move in the last one and a half months from minus 5 to minus 250, so it is really not possible to give any guidance in this respect. We monitor it continuously and try not to commit too much to term barrels, in order to maintain sufficient flexibility to take advantage of situations as they present themselves.

Domenico Ghilotti, Euromobiliare

My first question is on the fixed costs in refining, which were up in Q2. Is this related to the maintenance and should we expect a decrease in the coming quarters?

Second, the change in tax rate from Q1 to H1 was very small, considering the impact of the Robin Hood Tax. Could you explain why the impact was so small?

Third, could you explain the sensitivity around the CIP 6 tariff based on a higher oil price scenario, as you did in January?

Finally, are you already experiencing an increase in demand for 10 ppm products?

Dario Scaffardi

In terms of 10 ppm products, the regulations are such that gasoline and diesel would have to be of a 10 ppm specification at the gasoline station as of 1 January. What is happening, therefore, is that depot operators have to clean their systems, so they will need to start buying 10 ppm materials in advance of the deadline. How far in advance is difficult to say; it depends on the throughputs of these deposits. As a rule of thumb, it is generally said that you need to run the new product three times through the tank system before it is 100% clean. Depending on the throughputs, we expect to see purchases increase substantially in September/October. As of the end of October, all sales that we make to operators will be of 10 ppm material. Generally, in these situations, there are two reference prices: one is for the 50 premium and one is for the 10 ppm. We expect that it will command a significant premium to the standard 50ppm exactly like it happened when we had a change of specifications in the past.

Corrado Costanzo

On fixed costs, our guidance is related to the cash flow aspects. Based on what kind of maintenance is performed, we can discuss with our auditors what could and should be capitalised and what could and should be expensed. Last year, we capitalised more proportionally to the cash flow aspect than we capitalised this year during the turnaround maintenance, which is why more of the expenditure was posted to the P&L. The yearly guidance, as I said, is confirmed at €200-210 million.

On the tax rate, well done on your accurate calculations in what is a very boring subject. Taxation this year has been a nightmare. It is true that we switched from a 32% to a 37% overall income tax rate but, at the same time, part of the new tax base is tax at 16% and is part of the one-off Robin Hood Tax. That is why the effective tax rate, at least for 2008, is going to be lower. It is quite complicated; however, the fundamentals are still the same: a 37% income tax rate and a 16% one-off known as Robin Hood Tax. However, [inaudible] 50 million in different lines of the P&L [inaudible] the cash outflow will still be diluted over three years. Based on today's quotations, the 50 million would be substantially lower, probably at 35 or 40.

The CIP 6 full component sensitivity is not an easy calculation, but based on about $80 per barrel today, that component is €72 per MWh. We estimate that, based on $120 bl, we might see something around €90-100 per MWh, but these are broad calculations.

Laurent Saglio - Zadig

I want to return to a major transaction that took place in Italy in the refining business: the entry of LUKOIL into Italy. What does it mean for you in terms of your day-to-day business and your long-term strategy to have such a powerful integrated competitor alongside you? Do you have a view on the valuation that it was ready to pay compared with your own assets?

Dario Scaffardi

I see no significant change in terms of the market. LUKOIL was already present in the Mediterranean market with a trading arm called LITASKO, which was quite active and with which we have been doing business for several years, both in terms of buying crude and selling products. It is probably going to take on part of the position that ERG has, so, all in all, I do not expect any really major change. In terms of what it paid for ERG, it seems that, according to the market, it paid a substantial premium over what the majority of values given by analysts were, and I think this is what it needed to pay if it wanted to achieve a position in the Mediterranean that guarantees it a significant outlet for its crude oil production.

Laurent Saglio - Zadig

Can we make a comparison of the valuation with yours?

Dario Scaffardi

Of course, one makes comparisons. If you made the comparison, you would probably reach significantly higher values for SARAS than what the market is valuing it at today.

Corrado Costanzo

Each time a buyer knocks at the door, they are prepared to pay substantial premiums. Somebody's valuation here is off by definition. I will let you guess who that is.

Alexandre Marie, Exane BNP Paribas

Could you give us an idea of what kind of premium we should expect for 10 ppm over 50 ppm products?

Dario Scaffardi

At the moment, the premium is about $10-15. If we look at historical levels, for instance in 2004, when 50 ppm was introduced, the premium between 50 ppm and 350 ppm reached almost $70, so I would expect the premium to be $15-20. We would normally see some spikes in the latter part of the year, as people rush to buy 10 ppm because they need to clean their systems.

Closing Comments

Marco Schiavetti

Thank you very much for being with us today. Our next call will be in November for our Q3 results. Thank you.

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