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"First Quarter 2012 Financial Results" Conference Call

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Conductors:

Mr. John Costopoulos, Chief Executive Officer
Mr. Andreas, Siamisis, Chief Financial Officer
Mr. George Alexopoulos, Corporate Planning & Development Director
&
Mr. VasilisTsaitas, Investor Relations Officer

Conference Call Conducted by Chorus Call Hellas

OPERATOR: Good afternoon, ladies and gentlemen, this is the Chorus Call conference operator.

Welcome and thank you for joining the Hellenic Petroleum First Quarter 2012 Financial Results Conference Call.

At this time, I would like to turn the conference over to Mr. John Costopoulos, Chief Executive Officer, Mr. Andreas Siamisis, Chief Financial Officer, Mr. George Alexopoulos, Corporate Planning and Development Director and Mr. Vasilis Tsaitas, Investor Relations Officer.

Gentlemen, please go ahead.

COSTOPOULOS J: Thank you very much for the introduction. Ladies and gentlemen, good afternoon from Athens and welcome to this conference call where we will present and discuss with you the Q1, 2012 Financial Results for Hellenic Petroleum. I guess my top line comment is that despite a difficult and deteriorating domestic market environment, the Hellenic Petroleum Group announced for the first quarter of this year satisfactory results.

And on the strategic front, our Elefsina refinery major upgrade is now nearing completion as it is over 99% now completed. And the new upgraded refinery, which will I guess be a major turning point in terms of our strategy and development going forward, is ready for startup at the end of this quarter, or the second quarter 2012.

In terms of the major highlights of our results, in terms of the macro environment, we saw improved refinery margins in the first quarter versus the last quarter, but still somewhat lower than the equivalent quarter in 2011, but certainly better than the fourth quarter of 2011. And the FCC cracking margin was at $3.8 per barrel, which is about 8% below what it was in the equivalent quarter of last year.

Crude oil prices I guess, ups and downs with an upward direction of course, with a lot of uncertainty particularly on the…you know with supply-side concerns regarding Iran and so on and so forth. In terms of the Euro/Dollar exchange rate, we saw some stabilization particularly after the Greek PSI was implemented. And the EFSF, I guess was enhanced at the European level. And we saw the dollar averaging 131 in the first quarter.

Our domestic economy obviously continues to be seriously affected by a new round of fiscal austerity measures, and uncertainty in terms of the overall political environment. And that has impacted the demand for fuels which for the first quarter of 2012, was down between 8% and 10% versus last year. And we've seen a bigger drop of about 15% in heating gas oil, which obviously reflect the increased excise duty versus last year.

If we now look at our own operating performance, we sustained our adjusted operating results. This, I guess was mostly and mainly due to our continuous efforts to control our operating costs and our drive to continually to implement our transformation initiatives, which across the board in refining, in marketing, PetChems and international, in head office functions continue to deliver results.

So in terms of numbers, our Q1 adjusted EBITDA came in at €75 million, which is 5% ahead year-on-year supported you know, by a number of factors. On the one hand, we…as I mentioned earlier, we saw a further deterioration in domestic demand, which affected both our refining…domestic refining business and our domestic marketing operations.

Our Thessaloniki refinery achieved higher runs, which enabled us to increase our exports and we will give you more details on this front. In our international markets, our market subsidiaries maintained their performance despite you know, difficult environments and adverse weather conditions in some of our markets like Montenegro for example.

On PetChems, we saw increasing obviously margins of polypropylene, but the recovery was slower than what it was last year. So that has negatively affected our margins and hence our performance in PetChems versus the equivalent quarter last year.

And as I said before, we saw a lot of positive results and a positive impact on our results following the continuation of our transformation initiatives and cost control efforts. And on a Group-wide basis, our operating expenses were down quarter-on-quarter by 10%, which is a substantial decline.

In terms of reported EBITDA, it came in at a €108 million, which was due to lower inventory effects, the inventory effects was positive by €41 million versus €93 million positive inventory effect last quarter. On a net income basis, the adjusted first quarter net income came in at €45 million, which is a little bit higher than what it was in the equivalent quarter year-on-year, and our reported net income came in at €71 million.

If we look at our related companies, DEPA, the Gas Company, where we hold 35%, and. Elpedison, our JV…our 50:50 JV with Edison in electricity production produced €20 million, which is 90% below last year, affected really by a one-off provision at the DEPA level following arbitration with PPC, and again we will give you more results as we discuss with you in more detail the power sector.

Our financing costs were down €11 million in Q1 '12 versus €17 million in Q1 '11 because of reduced average working capital year-on-year. On our balance sheet, we, you know maintained our resilience despite the crisis in the Greek market. Net debt now stands at €2.3 billion which is flat year-on-year and our gearing stands at 48%, which is primarily driven by higher crude prices and heating gas oil increases at the stock level.

In terms of the Elefsis, as I mentioned, refineries I mentioned before, we are gearing up for a startup by the end of this quarter, and the funding needs, which will be transpiring as a result of you know, increased feedstock for that refinery have been taken under consideration in terms of planning our cash flows. And as the refinery will start generating obviously positive cash flows that will significantly improve our cash flow position and will enable us to commence our de-leveraging process. And we expect that over the next 12 to 24 months, we will substantially reduce the leverage of the Group.

On the strategic front, now I guess the big news is the upgrade in Elefsis now at 99% completion. And all of our utility units are ready for startup, they have been commissioned, there will be no problems now in our operation, and by the end of June of next month, the major hydro cracking units will be up and running producing diesel, which will enable us to supply the domestic market, but also to substantially increase our exports. And about 15 days after that, our flexicoker unit will also be up and running. So the latest I expect by the end of July, all our conversion units will be up and running and we will be delivering additional cash flows.

In terms of DEPA/DESFA, as you know, the sale process now is in Phase II as I am sure you've read in the press, and the announcements of the Hellenic Fund for Privatization, 14 parties have qualified in the first round of bidding. Regarding the open issues with PPC in terms of the PPC-DEPA contract, the option that PPC had and so on and so forth, all these issues are being settled and they will be ratified at the Extraordinary Shareholder Meetings of both companies, both DEPA and PPC. So if you will, a lot of the pre-conditions that were required to smooth the way towards the privatization have now been settled and agreed between the two companies.

Another important thing is the refinancing of our facilities, which our CFO will describe in more detail, which are coming up for refinancing in…some of them in December '12 and some of them in the first quarter '13. The refinancing process is in progress and as I mentioned earlier, following the startup of the Elefsina plant, we will proceed with deleveraging the Group over the next 12 to 24 months.

And finally, in terms of transformation efforts, the Group head count reduction plan, it was extended by a quarter, which is providing us with additional benefits of a €6 million reduction operating expenses. As we had mentioned in our previous conference call, adding that to the already implemented headcount reduction plan, the full benefit from the fourth quarter '11 and first quarter '12 headcount reduction plans will give us a positive contribution of €32 million on an annualized basis.

Now, let me turn to our CFO, Mr. Andreas Shiamishis, who will then take you in more detail through you know, the industry environment and then take you through the results of our individual business units.

SHIAMISHIS A: Thank you John. Good afternoon, ladies and gentlemen. Going through the rest of the presentation will involve having a quick look at the pages describing the macro environment and the market and then going on to the individual business units.

So without further ado, going to Page 6, we have the evolution of two of the key drivers, the crude oil price, which as you can see, escalated over the last few months leading to €40 million of inventory gains in our published results. And as you all know, it was actually a period during which we got to record prices at Euro levels.

In terms of the exchange rate, we saw some stability in the last few months following the PSI and the EFSF strengthening. This is clearly reversed now, as you go through the last couple of weeks of political uncertainty in Greece, but it is something which has given us a positive impact in our published results by about €18 million.

In terms of refining margins, we have a significant improvement I would say versus the last quarter versus 4Q 2011, from 1.35 to 3.8, which is pretty much along the same levels as last year's first quarter, about 4.08 in the first Q of '11. The situation is similar for hydro-skimming margins. We have pretty much the same level of margins versus last year's first quarter. So, no major changes on that front.

Here I would probably have to highlight the fact which we will come back to. In the refining sector that for the first quarter of 2012, we've been effectively affected by FCC cracking margins and hydro-skimming margins Elefsina doesn't operate so topping margins are not relevant for our performance, and clearly they won't be relevant going forward.

In terms of the market environment, clearly we are seeing a weaker domestic demand in Greece. The reduction of GDP, the austerity measures, the uncertainty is leading to a reduction in the demand for fuel. The auto fuels demand is down by about 8% to 10%, as you can see on this page. And we have a bigger reduction on heating gasoil, as people switch to alternative heating sources mostly for cash flow reasons mainly going into electricity based heating.

In terms of Aviation and Bunkering, we have a similar situation. Clearly the market is weak, as we see less trade in the Greek market. So, that means less bunkering fuel and gasoil.

Now, moving onto the overview of our results; in terms of segments we have the chart, which explains the key changes versus last year. Overall, we are at similar levels, marginally up, about €75 million of clean EBITDA versus €72 million. The biggest driver comes from…the positive driver comes from refining, where we had the biggest impact of cost control plus increased export and trading and price management. And on the other hand, that's compensate…that's offset by the weak domestic demand and the lower margins realized on polypropylene products in the first quarter of this year.

Our gearing is pretty much at the same level as the last few quarters. Traditionally at the end of the first quarter we have to finance relatively higher level of working capital because we come off the heating season. So if…if we have a change in demand by a few percent, then it can lead us to carrying higher stocks or higher receivables. So, this is quite normal for this time of the year, and our gearing is just below 50% at 48%.

Clearly, the projections for '12, '13 and '14, that we have here, are based on the fact that we are deleveraging as a result of the Elefsina startup. A critical issue for all Greek companies is the refinancing process and the maintaining of the capacity to be able to operate properly. And I think that over the last few months, the work that we did on the two facilities that mature in the next 12 months is such that enables us to be confident that over the next quarter or so we will be able to implement the refinancing of the first maturities that you see on the chart.

At this point in time, it's probably more difficult than it has been in the last month or so to give you some more specificity given the political environment that we operate in. But we are quite confident that once that is out of the way and we have some more stability in the market, this will be implemented without any issues.

In terms of the transformation benefits, clearly our focus remains on getting our refineries in a more competitive situation and driving the cost base in our retail business down as a response to the drop in demand and margins. So in the first quarter of 2012, we have been able to increase this self-help and benefits by about €12 million. So all in all, over the last few years, we've been able to generate an additional cash flow, which is close to €450, €500 million, if you add the last three or four years of savings achieved either in our EBITDA lines or in our CapEx lines.

Now, moving onto the individual segments; we have an improvement in the EBITDA for our refining business. One has to take into account the fact that, even though we operate our two refineries in Greece, the cost base is therefore all three refineries, and it's clearly there with the new organization of the Elefsina project that is expensed in the first quarter of 2012. So we have a slight inconsistency between our earnings and our cost base. So, as we get Elefsina up and running, clearly we will see an incremental, if you like a step change in our earnings being reported.

Our operating costs are about 1% down even though we are comparing to the first quarter when Elefsina was not operating for a significant period of time, and our non volume OpEx are down by 15%, which is…if you like an indication of the work done on the cost containment in the organization.

Thessaloniki is planned to shutdown over the next few weeks, which is a scheduled shutdown process, and we will be managing our supply chain over the next…over that period, with probably increased exports and transfer from us probably were to the northern half to meet local demand.

In terms of overall sales from our refining business, we are seeing an increase of 2%, clearly the higher runs in Thessaloniki allowed us to increase our exports and reduce imports to cover domestic demand, as you can see at the bottom of the chart at the left hand side of the page. The product yield remains pretty much in line with the refinery configurations. We have Thessaloniki which is a hydro-skimmer, which means we get more percentage of fuel oil versus diesel and more gas into our Group product slate.

In terms of production the following page shows the, the breakdown between the various refineries and the product slate that I talked about a couple of minutes ago. The following page effectively comes to give some more information on the Elefsina upgrade.

As John explained, we are pretty much close to the full startup of the refinery. Quite an impressive piece of work, it's the largest industrial investment in Europe over the last few years and clearly by far the largest investment and industrial complex in Greece. We have…I would probably say all units, other than the hydro-cracker and flexicoker, ready for commercial operation. And at the bottom of the page you can clearly see a couple of very nice pictures on how this complex looks during the evening.

Moving onto the domestic marketing, the messages here are probably less upbeat than the refining sector. Demand is weak, margins are fairly stable, and despite the fact that we've reported share gains in certain products, we are being very careful with our sales, mainly because of credit concerns and issues. So we are trying to run our business slightly more cash based rather than volume growth and margins.

Our international business aviation and marine is clearly impacted by the overall business curtailments or reduced activity involves coastal marine and air traffic. As I mentioned, we are seeing a stabilization on the margin of our retail business, and that is partly due to the micro pricing approach that we've adopted over the last few quarters, and more careful rebate policy throughout the networks.

Again here the key driver for maintaining and offsetting some of this negative impact of the crisis is the operating cost control, which is 10% down year-on-year and headcount costs are about 15% down again year-on-year.

International marketing is pretty much in line with last year, even though it's not totally trouble free. We have…the impact of the economic crisis in a lot of the countries we operate. We have been able to maintain our profitability and our performance. In certain markets, we've grown our volumes through wholesale business, and the most critical part of this business is first of all maintenance of a non-Greek based cash flow generation, and clearly the value of the vertical chain integration, as we have been able to increase off-take from the Greek refineries of the Group. So this is providing us an additional channel if you will, which ensures that we achieve a higher net pack than a simple export market.

As I mentioned on petrochemicals, polypropylene which is really the key driver of our business results, of our profitability, has been performing weaker than last year, I think last year's first quarter was an unrepresentative period because the increase of polypropylene margin was higher than what we had experienced in the last few years. So, the level of €10 to €12 billion of EBITDA per quarter is probably closer to the midpoint of the last few years. Again here we have targeted our operating cost basis, and we have been able to reduce that by about 10% despite the slight increase in volumes.

Moving on to the Power Generation business, Power Generation business is delivering relatively good results. As you can see, it's up about 20%...25% on last year's EBITDA numbers. And again it's the same on the EBIT where we have €9 million versus €6 million for last year.

Both plants are operating normally, we have been able to agree with DEPA on retrospective natural gas charges following NAT gas price adjustments in the last couple of years for some of the international suppliers. And clearly, this is a business, which is operating at…what I would say a steady state, there is nothing important in terms of capital investments coming up in the horizon. And I think the key…the key thing is to make sure that this business maintains its current cash flow generation.

Finally, we move on to the natural gas business, to DEPA. DEPA is a material part of the Group net assets it's about 25% of our net assets of the equity of the Group, just over €0.5 billion. DEPA had a good first quarter on the part of increased volumes and profitability. The operating profitability was up by 27% €131 million of EBITDA. And you can see the breakdown of the components of this profitability. This is based on unaudited results, which are produced only for the purpose of including them in the consolidation of the Group.

And effectively what we are seeing here is an one-off impact, which has to do with the settlement and the arbitration cases between DEPA, PPC and some of the customers, which is…it falls under the discussion that we had earlier where John explained that all loose ends, which have to do with DEPA are being resolved in order to facilitate the privatization process of the Group.

As you know, we have completed the first round of the privatization process we have 14 parties, which are qualified. And I think it's reasonable to expect that over the next few weeks and once the elections are out of their way, we will see a recommencement of this process.

As we normally do, I am not proposing to take you through the appendices of the numbers. I think at this point in time we've concluded our commentary on the performance of the Group and the business units. And we are here to take any questions you may have.

Q&A

OPERATOR: The first question is from Ms. Webster Laura of Bank of America Merrill Lynch. Please go ahead, madam.

WEBSTER L: Hi, I just had a couple of questions around finance cost and payables. I see that your payables number has dropped significantly quarter-on-quarter. Could you explain, maybe why that's happened and what we should think about going forward? And the second thing is your finance cost. You had very low finance cost in the quarter, but going forward with the high level of kind of short term dept and then low cash balance, what are your expectations?

SHIAMISHIS A: The payables balances, as you rightly pointed out has gone down since the year-end and that is mainly driven by the supply chain of the Group. Around the end of the year, we usually have a lot of CoCos coming in, heating gasoil and crude oil of course, which…in the first quarter of the year, we sort of use to fulfill our sales. So, if you take into account the normal credit terms that are available, usually you tend to see a reduction of payables in the first part of the first quarter.

The other thing which impacts that, is the fact that we are buying less stocks given that we are…and the increase at the end of March we always have a change of the compulsory stock obligation levels, which is reset according to the last calendar year sales.

Now, every year, we calculate the number, and we apply that at the first week of April. That means that in the first quarter of the year, if you have increased sales and CSO, stock obligations, you will tend to see bigger pressures, so you will tend to see bigger suppliers and building up the inventory. Unfortunately, we are not in that situation, because we have seen sales coming down over the last couple of years. So, at the beginning of the year, we tend to run down our stocks in order to take advantage of this reduced burden, which is what happened in this year as well.

Now on the finance cost, we have lower cost because we have lower average working capital year-on-year, first quarter of 2011 to first quarter of 2012. Again to a large extent, this is explained by the fact that if we compare to a year ago our stock levels are actually lower than what they were last year, again because we are about 10% to 12% lower in terms of sales in the domestic market.

The other thing which drives this reduction is the fact that, at the end of last year we put in place the structure with the compulsory stock obligation with OTSM, which holds about €200 million of inventory. So effectively, what we are seeing is the benefit of lower working capital in the first quarter of this year.

WEBSTER L: And then so we look forward with the refinancing, we are obviously expecting that cost to rise, is there any guidance from where you see that this year or next year?

SHIAMISHIS A: Yeah, well I think at the end of the day, you will not see a material increase in the cost of financing as we will have two opposite drivers. The first one is clearly, as you mentioned the higher cost of funds, which is anything between 2% and 3% on new funds that we will be borrowing. But on the other hand, one would expect to see the reduction of debt levels as we are very close to the completion and the start up of the Elefsina Refinery. So it means that the…the worst, if you like, is behind us, and we are starting to deleverage as early as Q3. So I think by the end of 2013, you will see the impact on finance costs being pretty much self eliminating between the two factors. Clearly, the faster we deleverage, the faster you will see the cost of financing coming down.

WEBSTER L: Okay. Thanks very much.

OPERATOR: Mr. Costopoulos, there are no more questions registered at this time. You may now proceed with your closing statement. Thank you.

COSTOPOULOS J: Okay. Well, thank you very much, ladies and gentlemen for joining us in our conference call. In terms of closing remarks, I just want to say that clearly we see…you know, we have seen the deteriorating Greek market environment and weakening refining macros. Nevertheless, as you have seen from our results, we've been able to manage, to sustain a satisfactory positive performance.

We've been focusing on operational excellence and cost control through transformation initiatives, which was I think elaborated quite extensively in a number of our conference calls in the past and today. And these obviously, are delivering a significant impact on our results and our competitiveness.

The start up of the Elefsis refinery in the next few weeks will highlight as I mentioned earlier, a major turning point for our Group and we will reposition Hellenic Petroleum among our peer Group in a challenging, I think liquidity environment. Our focus on supply and trading optimization, a proactive working capital and cash flow planning as well as tight risk management and a very prudent credit policy have proven key tools that have enabled the Group to maintain the resilience of our balance sheet and complete all our investment plans, hence if you will set in the platform for improving our results going forward in the short-term, but also as Andreas mentioned, reducing our leverage in the medium-term.

So, I think hopefully in our next conference call, we will be talking about you know, a different company with the Elefsis refinery up and running and positive cash flows coming in. Again, thank you very much for joining us this afternoon and you know, we look forward to discussing our results in a few months at the…after the second quarter. Thank you very much. Goodbye.