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"First Quarter 2018 Financial Results" Conference Call

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Conference Call Conducted by Chorus Call Hellas

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OPERATOR: Ladies and Gentlemen, thank you for standing by.

I am Gelly your Chorus Call operator. Welcome and thank you for joining the Hellenic Petroleum conference call to present and discuss the First Quarter 2018 Financial Results with the management of the company.

At this time, I would like to turn the conference over to
Mr. Andreas Shiamishis, Deputy CEO & CFO
& Mr. Vasilis Tsaitas Investor Relations Officer

Gentlemen, you may proceed.

SHIAMISHIS A: Thank you very much. Good afternoon, ladies and gentlemen, thank you for joining this call. We are here with Vasilis Tsaitas, with Ioannis Psychogios and George Alexopoulos, aiming to try and give you a full picture of the first quarter results and performance. And without further ado, I will go through this presentation.

Starting off with the key highlights, on Page 2, our performance for the quarter has been a strong one, not as strong as last year as expected because of the lower benchmark margins, and, of course, because of a much weaker USD versus the euro, which affects the gross margin, which means that our EBITDA at €149 million is roughly 35% down on last year and the adjusted net income of €62 million is down by 51% versus last year's first quarter.

On production and exports we have record numbers, we have the higher exports on records, it's 15% up on last year, which is driven by mainly the utilization of the refineries and the fact that domestic market especially heating gas oil has been lower due to weather conditions, of course, in 2018. That's also in terms of comparing with last year, in the specialties market which is effectively the power generation and the Army fuel is the fact that in the first quarter of 2017, we had abnormal situation with respect to power supplies, which meant that we had increased power generation coming from diesel units and also from natural gas fired units, which we don't have this quarter.

On the positive side, we have auto fuels up by about 4%, as you will see later on. This is driven both by gasoline and auto diesel. And, of course, it is something which is quite important, given that these are the highest premium products.

In terms of the refining performance, as in refining, supply and trading, we have a consistent what we call over performance or higher than the benchmark margin performance of just under $6.00 per barrel, which is consistent with the last few quarters in terms of over performance in the units.

On a reported basis, our net income at €74 million is again down year-on-year as expected, but still a very positive number. The reported results are clearly affected by the crude price evolution. The increase during the first quarter, which continued in the months up until now, has generated a positive contribution to the reported results. We estimate…these are our estimates, and they are effectively subject to the quantity sold, about €20 million of positive inventory effect on the reported results.

A good thing is continuous reduction of financial expenses, we are reporting about 17% reduction year-on-year, and that is the result of both lower interest rates, as well as, lower debt.

On DEPA, as I mentioned earlier, we had the abnormality in 2017 of the first quarter, and in 2018, we have slightly more normal conditions with respect to power generation. And, of course, the warm weather which meant lower natural gas demand for retailers.

On cash and balance sheet, we have an operating cash flow which is a definition that we explained effectively the adjusted EBITDA minus CAPEX, what we need on a cash basis to run the business of a €122 million, a strong number, it continues to be strong, it has been strong for the last few years and net debt at just under €2 billion as a result of seasonality on the working capital and an increase in terms of receivables and stocks.

Another positive thing for the quarter is that we have refinanced all of the 2018 facilities. We have improved maturity profiles for debt. We have reduced the cost of debt by roughly 2 percentage points versus last year and this will be more visible as we move into the second and the third quarter of 2018.

Turning on to Page 3, we have some key developments which relate to the sales process of Hellenic Petroleum. As announced here today, we had the expression of interest by five consortia, five interested parties. Very early in the day to be able to comment on that, that's why I am making this comment upfront. We don't have anything more than what has been announced by TAIPED and our shareholders.

However, what we do have and we have announced is that the agreement for the sale of 66% of DESFA was also approved by the Hellenic Petroleum EGM, and as a result of that we expect that this transaction is moving forward probably with a completion of the requirements within 2018 and a closing of the transaction if everything goes well in the first quarter of 2019.

Staying on the DEPA and the natural gas group, we have DEPA announcing the sale of 51% participation in the EPA Thessaloniki and Thessaly to ENI. ENI was a shareholder of 49% and it is controlling the retail gas companies there. The transaction was completed with a consideration of €57 million. We expect the closing for this transaction to take place within 2018 and further transactions in terms of restructuring DEPA Group post the DESFA sale completion in progress.

Finally, we have the upstream projects, which are in progress and we have submitted offers for two offshore areas, one with Total and ExxonMobil, and the other one with Repsol. The assessment, the first…the preliminary assessment is actually taking place quite soon, it has actually started and we expect this to be completed in the next few weeks.

Moving on to Page 04 with financials, I will not go through the page with all the number. What is new to this format is that we have added a last 12 months column, which we will be updating on a quarterly basis. This keeps us slightly more recent KPI if you will, of the performance of the company with the environment prevailing over the last four quarters.

So as you can see, the performance of the first quarter of 2018 at €149 million is effectively substituting in the 12 months, the 229 which was 2017 first quarter results. So the full year performance if you will, if everything was frozen at this point in time would be around €740 million of adjusted EBITDA which again is a result of the weaker refining macros that we are experiencing.

You can see the contribution of associates being lower, as I mentioned we have…the primary driver is the DEPA Group results which are weaker this year, because of the weather, and the abnormally high Nat gas power supply in 2017, and that is actually the same for Elpedison as well. Financing costs, as I mentioned 17% down and we have an adjusted net income of €62 million and a reported net income of €74 million in 2018 Q1.

If we move to Page 06 on the environment; the recent developments on crude oil price have moved the…if you will the indicator, the index that we are following, the ICE Brent price, quite higher in the last few months. We see that since the third quarter of 2017, we have experienced an increase in the average result or all averages…average price of crude oil.

Q2 is expected to be even higher than Q1, which, of course, drives improved reported results compared to adjusted numbers, higher working capital requirements and slightly different economics, 'ceteris paribus' with higher crude oil prices.

The other factor, which is important, is the weakening of the US dollar, which affects pretty much 80% to 90% of the gross margin of the group. Very few sales, I think probably we are referring to engineering and petchems, which are driven by euro, everything else is driven by the dollar gross margin which means that a weaker dollar will have a negative impact on the results. The crude differentials here you can see, we track the Brent-WTI, and of course, the Brent-Ural crude, which is a bit higher for Q1 at $1.7 per barrel.

Moving on to Page 7, we have the margin outlook, hydrocracking margin outlook. The only positive thing for the quarter relates to the diesel cracks which have been maintained quite strong. As you know this is beneficial for the Elefsina refinery which is reporting even better results and of course, as a Group, we've a middle distillate yield slate of over 50%, it is something which helps us to perform better than refiners who have a bias to gasoline.

On Page 8, we have the evolution of the domestic market sales. Clearly, the first quarter has been driven by the heating gas oil demand drop by more than 22% and the increase in the auto fuels sale both diesel which is the main driver and gasoline. In all honesty, one would have to wait for another quarter or two before making a conclusion on the auto fuels increase given that beginning of 2017 has a distortion because of the increase in tax, in custom rates in January 2017 which meant that some of the sales were moved to 2016, so again the comparison may not be 100% representative, but clearly the positive sign is there, and it is very good news.

On Page 10, we have a summary view of the performance at an EBITDA level…adjusted EBITDA level. It is quite self-explanatory in that the change from last year's Q1 is almost entirely accounted by the lower benchmark refining margins and the weaker dollar. We have clearly improved performance in the refineries, but still this is not enough to offset the weaker environment.

Page 11, we have the refinancing in slightly more detail as explained earlier. Gross debt is down by €170 million and the refinancing transactions that we discussed earlier are effectively shown here. We have completed the refinancing for 3 facilities; one is a €400 million new facility which effectively replaces the €380 million syndicated facility with significantly better terms.

A new quarter of a billion dollar facility, which is a 3-year facility which will help to manage the asset/liability currency exposure that we have, and a new line for roughly €300 million which was put in place a few months ago, and that is being used to repay a standby facility of €240 million that we set up in 2016. So as you can see, we have a very even and improved debt profile…maturity profile. The 2018 is expected to be rolled over for another 18 months. It has been rolled over in the last 3 to 4 years, which means that the maturity profile of the Group is looking quite healthy.

Moving on the individual business units on Page 13, we have the details for the domestic refining, supply and trading. Again, a very good performance in terms of operations and even in absolute terms the reported results are very positive. However, we have a 16% loss on benchmark margins and 16% loss on the euro/dollar exchange rate. So there is not much we can do to offset these big swings.

In terms of operations, the production of the refineries is at the highest level, almost 4.5 million tons for the quarter and you can see the composition of crude and feedstock on the bottom of the page and the refinery yield for the quarter with more than 50%, 51% to be precise, being middle distillates, and almost 80% to 85% being premium products i.e. gasoline and naphtha.

On the supply and trading on the sales part, we have on Page 15 the breakdown between the 3 main channels being the domestic market, the aviation and bunkering which going forward, we are considering splitting into two because they are two different markets. And of course, exports through own companies into third parties. We can see that exports is up by 15%, it's the highest number for a quarter that we have reported in the Group.

Page 16 shows the consistency of the over-performance of the improved realized margin compared to the benchmarks. This effectively goes to support the claims that Hellenic Petroleum, it's not only a system of refineries, which is very efficient and very complex, but also has the benefit of being able to extract and deliver high value per barrel as a result of either technical over-performance or crude oil optionality or commercial premium that we enjoy in the domestic market.

Page 18 has petrochemical, which is effectively a vertical value integration business on the refinery, relatively consistent. We have €26 million of adjusted EBITDA for the quarter, marginally down versus last year, but given the relatively low capital expenditure requirement, this is a very cash positive business.

Moving on to Page 20, on the domestic marketing front, we have a performance, which is pretty much at the same level as last year, despite the fact that we have a much lower sales volume as a result of the heating gasoil season.

The business…retail business in Greece is relatively weak in the first quarter given the seasonality. We have Q2 and Q3 being the highest quarters in the year, aided not only from petrol station performance, but also from aviation and bunkering, which really picks up towards the middle to the end of the second quarter every year.

International marketing, on Page 21. International marketing delivered slightly improved results, mainly as a result of improved retail margins. Some wholesale volumes in Bulgaria have been lost, but usually this is relatively low margin throughputs, which doesn't have a huge impact on the country's profitability. Having said that, it is quite obvious that the metrics for the international marketing business are totally different to Greece given that it's a different model, its COMO model versus a DODO model which is a big chunk of network in Greece. This is something that's been addressed and it is something that we gradually moved to more contribution and participation of COMO petrol stations in the network for Greece as well.

Finally, moving on to Page 23 and 24, we have the power generation. The performance of Elpedison has been affected by the lower gas-fired unit's participation in production. And of course, the delay of CACs, the capacity and flexibility, remuneration mechanism, which is expected to be implemented for the New Year with a few months' delay. So, we expect that to take place over the next few weeks.

On DEPA, we are still reporting the results of DEPA as if we consolidated on equity basis all of the DEPA Group, which includes DESFA. The results of the Group lower than last year simply because we have a drop in the sales volume mainly because of weather and of course, the lower power generation that I mentioned earlier.

In terms of privatization developments, we have the transaction approval by the sellers. And we have the process for making sure that we obtain all regulatory approvals required and hopefully be able to conclude the transaction by the end of the year and have the closing…and the cash changing hands in the first quarter of 2019.

In this year, however, we are expecting to receive a dividend of €16 million coming from DESFA plus any dividend which will be added from the DEPA results.

With that, we come to the end of the presentation of the main business units. And we are available to take any questions or comments you may have. Thank you.

Q&A

OPERATOR: The first question is from Grigoriou Giorgos with Pantelakis Securities. Please go ahead.

GRIGORIOU G: Yes, hello. Two questions, if I may. First of all congrats on the results, you managed once again to beat estimates. The first question relates to CAPEX, if you can comment what happened during the quarter, it was actually a bit increased versus your usual run rate? And the second question relates to your effective tax rate. If I am calculating right, it was a bit lower than usual or typically, if you like in the first quarter? Thank you.

SHIAMISHIS A: Thank you very much for the question George. You are absolutely right on both the legs of the questions. CAPEX is up from 2017, the €27 million is more representative for the full year, and we expect to have a full year CAPEX which would be around €120 million to €150 million. So it has to do with the phasing of the projects. Last year's CAPEX was higher because we had a major shutdown. We have a couple of smaller shutdowns, which are coming in the next few months, one of them is taking place now, but the CAPEX number is probably more representative. So while we would expect on an even basis to have around €30 million to €40 million third quarter as you can appreciate these things tend to have a slightly abnormal phasing which is why we cannot sort of smooth it out.

On tax rates you are absolutely right; it's a very valid question. You know, we have the pleasure for the first time in many years to be able to claim that we have been proven right for the treatment of certain taxes. I think, going back to 2004-2005, which had to do with some special reserves for CAPEX. We were asked to make a payment back then it was probably back in 2008 that we actually made the payment. We resorted to legal proceedings to claim that tax. And we finally collected in the first quarter of 2018 about €7 million or €8 million of taxes, which affect the income tax expense line and effectively drive the effective rate down by about 6 to 7 percentage points. So it's a valid point, yes. You're right.

GRIGORIOU G: Thanks, about that. Yes, I am sorry, I didn't have enough time to go through your accounts and I could actually read it through as well here, sorry. Just to go back on CAPEX and the shutdown, you mentioned, a follow-up two questions, I can see you've got about €16 million acquisition of further equity just in the subsidiary, you're right. If you can give us some more detail on that? And the second thing relates to the shutdowns you mentioned or is your scheduled shutdowns for each of the three refineries in 2018? Thank you.

SHIAMISHIS A: Okay. On the subsidiary, I will ask George Alexopoulos to take that question. And then, Ioannis Psychogios can give us some more details on the shutdowns.

ALEXOPOULOS G: Hi, George. It is George Alexopoulos here. The acquisition concerns the acquisition of the remaining 37% in EL.P.ET. VALKANIKI which is a holding company that owns OKTA and VARDAX pipeline, we acquire that from Greek banks who were our partners there, and they were required to divest in the context of their programs following the state aid they had received. So this is the acquisition you are referring to and the consideration was €16 million.

SHIAMISHIS A: Ioannis.

PSYCHOGIOS I: So for the refineries maintenance plan for the year for 2018 what we can say is that the plan for this year is very, very light. We have, at the moment some catalyst changes in two minor units in Elefsina refinery. The main units of the refinery has, flexi-coker and hydrocracker are in full operation. And we will have a minor pit shot in Thessaloniki refinery for some cleaning of some exchanges for five or six days. So it is…this year if everything goes as schedule, we would not expect to have any other maintenance activities in the three refineries.

GRIGORIOU G: Excellent thank you.

OPERATOR: The next question comes from Mr. Gkonis Argyrios with AXIA Ventures. Please go ahead.

GKONIS A: Good afternoon, gentlemen. Small question from my side, I am looking on the unit OPEX on the refining operations, and I also checked on the press release that you mentioned that this has been affected somehow by the increased CO_2 costs, can you give us a bit of…can you elaborate a bit further on the cost side, are you looking on a dollar per barrel basis or euro per barrel basis whichever you prefer, can you give you us an idea how has this CO_2 costs affected and to what extent has it been affected by the CO_2 costs? Thank you.

SHIAMISHIS A: Hello, yes it's quite…it's becoming a more important topic than it has been in the last few quarters. First of all, I don't have available cost per barrel to give you not for any other reason but because with way the CO_2 allowances work is slightly more complicated per barrel. Effectively, you have an allowance which is moving away and you have to buy any shortfall that you have in the year. In 2018, in the first quarter, we've seen CO_2 prices which are euro per ton going up to roughly €16, €17 per ton and in the first quarter, we have had an increase in our operating costs of about €4 million compared to last year.

So it is something which will be here for some time. We expect that the cost of CO_2 allowances for the Group will be higher going forward than in the last couple of years. Now whether the price remains around €15, €16 or whether it moves up to €20 per ton, it's very difficult to project. But if I also take a view I would say that the expectation is going to be higher than what we have now, which makes it an expense which is going to be around €25 million to €30 million per year.

GKONIS A: Okay, thank you very much. That's clear.

OPERATOR: The next question is from Mr. Chatzidakis Manos with Beta Securities. Please go ahead.

CHATZIDAKIS M: Hi, everybody. Thank you for taking my question. Can you give us some color regarding the Iranian oil claim, how is this evolving and at what level this obligation is paid? Thank you.

SHIAMISHIS A: Yes, on the Iranian payables number, as you know, as you have been following the company. We are not at liberty to disclose a number because of the confidentiality agreement we have with NIOC. However, what I can mention is that…what I can say is that, as we speak, this number is…I would dare say not material for the Group size; it's not more than probably a month's credit of crude oil from NIOC. So we have effectively settled the significant part of that payable and it is not something that should be of concern going forward.

CHATZIDAKIS M: Okay, thank you.

OPERATOR: Ladies and gentlemen, there are no more questions registered at this time. You may now proceed with your closing statements. Thank you.

SHIAMISHIS A: Thank you very much once again for taking the time to listen into the conference call and the announcement of the first quarter results. All in all, it is a strong set of results, it continues to be a proof of concept given that all the investments and the efforts being put into the Group is to have complex and high net cash margin refineries which will be able to deliver anything between €600 million to €900 million of adjusted EBITDA year-on-year and depending on benchmark margins and euro/dollar exchange rates. The performance of the refineries has been very good in the first quarter and we hope that it's going to continue to be strong.

We have a few minor pit stops, as Ioannis called them, which we expect that will not affect the performance significantly. The market seems to be performing I would daresay a bit better than in the previous couple of years. Clearly, too increase is a very positive thing for the domestic market. And we are seeing a gradual recovery of domestic consumption and demand as well. I cannot quantify that at this point in time and say it's going to be a 2% or a 5% recovery on the market, that's taking out heating gasoil of course. But clearly it's a positive sign.

The Group is progressing through a number of strategic transactions, the natural gas DESFA transaction is something that we have worked on for a long time and it's finally coming to an end, which will…it will provide some additional capital to be used for deleveraging and some shareholder returns. And of course, we are expecting to see further developments on the natural gas business over the next few months. All in all, a good quarter for the Group and hopefully a quarter that will provide a positive entry into 2018 and 2019. Thank you.