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"2011 Interim Financial Results" Conference Call

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Mr. George Alexopoulos, Corporate Planning & Development Director
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Conference Call Conducted by Chorus Call Hellas

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

Welcome and thank you for joining Hellenic Petroleum 2011 Interim 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: Good afternoon ladies and gentlemen, it's John Costopoulos on the line. Thank you for joining us on this conference call where we are going to be discussing with you our Second Quarter Results.

Let me go straight into the material, the presentation you have in front of you. I think that you know the overall message is that within a rather difficult environment both in terms of the overall refining industry environments and also the very challenging domestic market, I would say that Hellenic Petroleum delivered a positive set of results for the second quarter of 2011.

Clearly, you know the condition do remain difficult. The benchmark margins across all types of refineries remain weak. This as we all know is partly due to the volatility in crude oil prices. We've seen, you know the average cracking margin, benchmark margin for the second quarter, you know hovering around $3 per barrel when the equivalent was over $5 in the second quarter of 2010. So clearly, you know weaker margins and in simpler refineries, like the hydroskimming refinery we have in Thessaloniki, the margins went as low as minus $5 per barrel when in the equivalent quarter last year they were hovering just below zero, the zero level.

Now, in terms of the, you know on the volume side, clearly the domestic environment remains very challenging. The, you know the latest results in terms of the domestic market that we have from the, you know, the overall Greek market is that the auto fuels volumes was down about 10% in the second quarter.

However, you know there is some you know, a brighter side to this that as the quarter was ending we have seen a gradually improving rate of decline if you will in the domestic market. The domestic market is beginning to stabilize and we've seen that you know, both on the wholesale, but particularly on the retail sales of our two retail subsidiaries EKO and Hellenic Fuels with the BP brand that the volumes are beginning to flatten out versus last year. So, it appears that you know, the market is reaching its lowest levels and hopefully things will somewhat improve going forward.

Now, if we turn to the numbers as I said, overall the performance can be characterized as positive in the second quarter. On an EBITDA level if we look at the second quarter adjusted EBITDA adjusted obviously for inventory effects, but also for various one-off items that we will describe later in detail came in at a €144 million. So we are about 20% below the equivalent quarter of 2010 and as far as the six monthly results are concerned adjusted EBITDA came in at €217 million which is 29% versus the equivalent six month of 2010.

Now, this has been driven by relatively satisfactory refining results because you know the slackness of domestic demand was somewhat, if you will, addressed by increased international trading and of course, we were hit also by lower margin as I said earlier on by weaker dollar versus euro.

On the other hand, we maintained our strong efforts on controlling our operating expenses both through if you will the continuous implementation of the transformation efforts that we are implementing throughout our Group which are being… obviously are bearing fruit but also through even more you know, drastic cost controls and very tight cost controls. And of course, the OpEx numbers benefited if you will also from the reduced refinery runs in Elefsis, where the upgrade investment is going forward and in Salonika, where we complete the tie ins, and we are in a startup mode right now, so obviously those had a positive effect on our OpEx levels.

In our other businesses, we've seen good results, particularly good results in petrochemicals because of the sustained good margins on polypropylene which is the bulk of our business and a major export item for us.

We were able to sustain a very good performance, but we've seen also very good numbers which show obviously at the net income level from our participation in DEPA, you know the gas company as well as our participation in the Elpedison joint venture. Both of these companies contributed €12 million to our pretax bottom line, versus a loss if you will in the equivalent quarter last year.

So our reported second quarter net income came in at €60 million and the adjusted came in at €93 million, almost 60% ahead of the equivalent from last year. This was helped as I said, by DEPA and Elpedison results, but also by the effect of the weakening US dollar on our dollar denominated loans. So you know, from the revaluation of those dollar loans, as well as a €12 million reversal of a provision for tax dividend following the implementation and the passing of the new tax law that is affecting tax on dividends.

On a more macro basis or strategic basis, clearly the focus of our management remains on completing the large Elefsis refinery upgrade. Our progress now is well above 90% and we expect that the mechanical completion will be achieved by the end of this year by December 2011. In Salonika, as I had mentioned also in our previous conference call, the refinery upgrade has been completed and we are actually as we speak in a start-up mode.

Also, we continue to review all the various investments we have in Greece and internationally and we, as I had mentioned also in the past, are, you know are planning to divest from assets or businesses that are not core where we don’t have, you know critical mass or long term strategic interest. So, within that overall strategy we proceeded with the divestment of EKO Georgia, our retail company in Georgia; it was a small company obviously. We got cash consideration of €6.6 million and that deal was completed around the middle of July.

In the upstream also as you recall, we proceeded with the divestment of 70% of our participation in a concession in West Obayed in Egypt and we have gone through the EGPC approval. We now are waiting the final stage which is basically the final approval from the Ministry of Energy which would be happening any day now.

Another important thing that we will talk a little bit more about in this call today is the successful completion of a long almost six month long negotiation with our labor unions both at the Hellenic Petroleum level within our refiners, but also with our union at EKO our retail subsidiary. We completed this long negotiation in line with our strategy which was to increase competitiveness, improve productivity and try to bring the compensation levels more in line with our, you know, current economic environment.

We were able to complete this negotiation and we've signed a collective agreement which basically will last for three years. The cumulative benefit from this new collective agreement over the three years i.e. over you know, the remaining of this year 2012 as well as 2013 will be about €54 million for us or the substantial cost saving.

It will come both in terms of increased, you know productivity, reduced overtime, but also reduced level of benefits for some categories of employees. We will give you more details later if you want. That can be split to €43 million from the… for Hellenic Petroleum at EBITDA level and the remainder for EKO.

Now clearly, this achievement is positive, but it also had a cost for us in the second quarter as we incurred one-off losses due to reduced you know, sales levels and sales premium but also reduced refining margins and loss of petrochemical margins and volumes to the tune of €26 billion, which of course are reflected in the numbers of this quarter.

I will not go through the details on page 4, I am sure you know you run over it and I think I will pass on to the rest of the presentation and discussion to Andreas Siamisis, our CFO. Andreas.

SIAMISIS A: Thank you, John. Moving to page 5 effectively you have the parameters, the key parameters for our business which John explained a little while ago. We have seen in terms of the margins a reduction both in complex as well as simple refineries. And as a result of that, as you will see later on in the presentation, we effectively run only as probably was for most of the second quarter, which is why you will see that the participation of cracking margins in our total production is about 99%. This actually explains the improvement in the average refining margin of this quarter.

The other point on this Page, that I would like to draw your attention on, is the chart on the USLD HSFO spreads, because that is effectively a number which is quite critical to the Group. As we move towards the completion of the Elefsina refinery, this is a number which will become extremely relevant as it reflects the upgraded refinery and economics and it drives the additional EBITDA generation for the next year.

In terms of performance by segments, you will see on Page 6, a graphical presentation of the deltas between this quarter and the same quarter in 2010. Clearly refining reflects the biggest drop as being the largest business units for the Group. And it's driven entirely by the adverse environment that we talked about a little while ago.

Marketing, again we have a double story there. We have the domestic marketing being affected by the Greek market conditions of lower volumes and margin pressures. Even though we have to say that for the second quarter petrol station network sales have been pretty much in line with last year, which is a very positive sign. And we also have the international business performing quite well, maintaining the profitability of last year.

Petchems, as you can see, there is a small drop there, and E&P effectively… the increase in the contribution of E&P is effectively a reduction of our cash call commitments following the farm-down on the West Obayed assets. So, all in all, we have €144 million for the second quarter versus €183 million for the same period of last year, which taken into account the environment we believe is a satisfactory performance.

Clearly profits are not the only number which matters for the Group, particularly with the current environment. So, cash flow is also something which is monitored very carefully. What we've tried to put here for you is effectively an explanation of our cash flows during the six months of the year.

The big picture is that if one was to take away the upgrade project, effectively the cash generation of the Group has been even in this difficult condition has been quite strong and sufficient to cover for the increased working capital, which came about from the higher crude oil prices and product prices. So, the message is that, the underlying cash flow generation of the Group has remained quite strong.

Clearly, the fact that we are investing a significant amount for the upgrade of the Elefsina refinery and up until now the Thessaloniki refinery, which we completed, requires us to increase our debt for the next 6 – 9 months until the completion and the full generation of the additional cash flows from the new refinery.

So, all in all, we have an increase of just under €2 billion of debt which as you can see on the following Page, is about 45% of gearing measured as debt over capital employed. Above our long term target range, which is about 25% to 35%, but as I mentioned, this has been something which was planned all along over the last three to four years, in order to finance the increased investments in the upgraded refineries.

As you can see from 2012 onwards, we expect this number to come significantly down as we have cash generation from increased profits, as well as lower CapEx. Just to give you some numbers; our EBITDA and CapEx today, effectively the combination of the two is generating a pretax and pre-working capital outflow of about €200 million. With the new refineries in place, that number will be about €600 inflow as we have higher EBITDA and significantly lower CapEx. So, I guess we have to sort of wait for another six to nine months and then see how this affects our debt levels.

On the following page, we effectively repeat the benefit of the transformation initiatives, which we undertook over the last two to three years. The benefits from transformation projects have been lower than in the last few quarters, mainly as a result of the fact that we have two refineries in a shut-down mode. So, the benefit that would accrue from the operation of the two refineries is not there.

And mainly as a result of more focus on the completion of the upgrades versus the implementation of all the benefits. Clearly, as a Group we need to prioritize our resources and today, the most important project for us is the completion of the new refineries.

Moving on the business units, on the domestic refining, supply and trading, we have a lower sales volume of about 20%, which is mainly the result of lower production runs, i.e. lower exports sales, and you can see that on the chart next to the table, where we have significantly lower sales in the export market, and we have adjusted results, adjusted EBITDA results which are just under a €100 million. As a result of the adverse environment and the compensation of that negative effect by increased trading in the international market.

The impact of strikes is €20 million for the refining business, as John mentioned earlier, that was an one-off loss that we incurred, which was however, well worth it given that the benefits of repositioning and rationalizing the biggest component of our cost, which is the labor cost, is something which will be with us for years to come. So, even though we are recording a benefit of just over €50 million… €55 million for the first three years, clearly a significant part of that will continue to exist in the years to come.

Now, you can also see here the breakdown of sales by product and clearly given that the two simple refineries were in a shut-down mode, the product slate was in favor of distillates of white products and Middle Distillates and MOGAS**.**

Now, you can see on the following Page, on Page 12, you can see the production by refinery and by products, where you can easily identify the absence of the Elefsina and Thessaloniki refineries. Thessaloniki upgrade was completed at the end of…within the first quarter and the refinery was shutdown for a maintenance… for maintenance work and the revamp of certain units so that it can be linked into the new refinery.

Thessaloniki is currently in a startup phase and clearly we expect that over the next few weeks to start producing from the new refinery. The drop on the Aspropyrgos production relates mainly to the strike impact, that’s why you see there is a 15% drop on that refinery.

Moving on to the marketing business; marketing business in Greece as I mentioned earlier, has had some positive signs in terms of sales volume. Sales volume in the petro network have been pretty much in line with last year’s second quarter at 485 thousand tones… albeit at depressed margins , clearly there is a margin pressure in the market this is quite evident from the results we are publishing and that is something which the whole industry will have to face over the next few months.

Our sales volume was assisted by the marketing initiatives and from the promotion initiatives both on the EKO network as well as the BP branded network. And as a result of that, we have been able to gain some market share in the domestic market.

Moving to the International Marketing, the message on the International Marketing is one of relative stability, we have a small drop on the profitability from the core markets. This is due to a number of reasons, a different one for each market. Clearly, international is not suffering as much as the Greek market.

However, we remain quite cautious as to the next 6 to 12 months outlook, which is why we are not investing in increased federal station networks, as aggressively as we have done in the past. I guess the, the message there is that we need to maintain our position in those markets, maintain the cash generation from those markets and manage our risks, credit risk or any other exposures as tightly as possible.

Petrochemicals, the impact on the production of refineries has been quite profound on the petrochemicals business as well, given that a number of the products are actually bi-products of the refining process, the polypropylene value chain has been quite strong and is driving about 90% of the results of this sector, which is why on an adjusted basis i.e. taking into account the one-off impact of the strike, we have a relatively modest drop on the adjusted EBITDA of the business unit.

Moving on to our associates in the power and gas business, we are quite pleased to report a very strong result from Elpedison, we have an EBITDA number of about…of a just under €20 million for the second quarter, which is good news for us. That has been a result of a number of factors; first of all, clearly there is some benefit from the re-pricing of the capacity certificates versus last year.

The switch from lignite to gas fired plants as a result of problems experienced by PPC due to strikes has been a key factor for the improved results. And in some cases, we have seen the SMP reaching the cap, the regulatory cap, which clearly benefits Elpedison profitability.

On the back of that, we see the results in the natural gas business being significantly improved as well, as more gas fired plants are deployed on a daily basis, clearly DEPA sells a lot more gas into those units that is why we have a 20% increase in the first half of the year versus last year. However, it hasn't been only trading results which have been good; we have seen some improved results as it was expected by DESFA, which is the regulated-based business as well as the regional supply companies, particularly from EPA Attiki. Now you can see the numbers for DEPA and the sales volumes of natural gas by quarter on Page 17.

I think that brings us to the end of the presentation, I am not proposing to go through the financial appendix with all the numbers and we are happy to take any questions you may have on the presentation in our business.

Q&A

OPERATOR: The first question is from Mr. Katsenos Nikos of Alpha Finance. Please go ahead.

KATSENOS N: Yes good afternoon. A couple of questions please. Firstly, could you please remind me the benefits from the labor agreement what percentage of the total labor costs account for? Secondly, in terms of the domestic marketing it seems that you are gradually reducing the network. I am wondering, whether you could give me an idea of the number of the points of sales that you would see as appropriate for your business? And thirdly, in terms of the power generation business, could you please give me the number of the electricity generation of your power stations in the second quarter in terms of gigawatt hours and could you please compare this to the first quarter? Thank you.

SIAMISIS A: Hello there, thank you for the questions. On the labor benefits question, the…if I was to give you a simple straight forward number, I would probably put it is as a percentage between 6% and 8% of our total payroll costs. That effectively comes about from two main factors, the first one is the increase in the working hours and the second is the abolition of… or the freezing of certain automatic increases. So, I think that this is a very good result for us, clearly that is less than what we would like to do, but it still is a very good step in the right direction.

Now the second question was with respect to petrol station numbers. I think that we are not in a position to give you a target number for the petrol stations.

I think the comment there is that we all know that the Greek market is over pumped, we have more petrol stations than what the market should have. I won't say it can afford because that is different comment, clearly having the biggest percentage of the market with 30% market share, we are keen to see a rationalization of the market. What we are not keen to do however, is to effectively give up market share on our networks and leave room for smaller petrol stations to take those sales away from us.

So, I think the answer there is that our aim is to at least maintain if not grow our market share and that can be achieved through a number of petrol stations that is needed. Now, the third question was on the sales of power, let me just see if I have this detail with me and… no; I am afraid I will have to get back to you on that in terms of the actual amount of energy sales for the second quarter.

KATSENOS N: Okay perfect. Thank you very much.

OPERATOR: The next question is from Mrs. Dunphy Elaine of Deutsche Bank. Please go ahead.

DUNPHY E: Hi, good evening guys. I have just two questions. First very quick, could you just remind us what your current market share of the Greek domestic market is? And the second is, I was just wondering if you could update us perhaps on your intentions regarding your stake and that I know, the government is planning to divest its stake towards the year-end?

COSTOPOULOS J: Well in terms of domestic market share, I would say that on the wholesale market, our market share is around 66.5%, 67% and in terms of retail share, our market share is between 29% and 30%, if you take the EKO and the BP brands together. In terms of… DEPA, what was your question again could you repeat it?

DUNPHY E: I was just wondering if you could update, I know the government is planning to divest its 65% stake, you obviously hold to the other 35% and I was just wondering if you had any intentions that perhaps divesting your stake or perhaps stake you know, buying out the government 65% stake, hope you can comment?

COSTOPOULOS J: Well, I mean the only comment I could make is that, you know, we are watching very closely and monitoring very closely what the government is trying to do its stake, because depending on what they want to do in terms of taking the company forward and how are they going to divest and you know, which parts are they going to divest and so on and so forth, will obviously lead to a different response strategy from us. So, I cannot really tell you what our strategy is right now. I mean it's you know, it's kind of… I wouldn't say confidential but it is strategic for us.

The only answer I can give you is that certainly what we want to do is you know maximize you know value creation and I am not necessarily saying maximize short-term value creation, but maximize value creation for the Hellenic Petroleum Group. So you know, we will see what the government is trying to do, we are not clear exactly what they want to do and when they want to do it, but we are monitoring very closely and we will certainly implement the value maximizing strategy value for the Group.

DUNPHY E: Okay. Thank you.

COSTOPOULOS J: Sorry, I cannot be more specific on this.

DUNPHY E: No, I understand.

OPERATOR: Gentlemen, there were no more questions registered at this time. You may now proceed with your closing statements.

COSTOPOULOS J: Well, I guess it's rather you know, Andreas and my presentation was very clear and the numbers are very clear to you or maybe you know, it maybe drinking time, whatever it is. But, anyhow, thank you for being with us for the review of the second quarter results. You know, all I can say in terms of parting results is that you know we are operating in a difficult environment.

I think that nevertheless, through a lot of self help you know, and a lot of effort through the management team, be it the transformation initiatives, the negotiation of the collective agreement, the push forward with our upgrades, our trading activities, costs controls, risk management, we are able to deliver a, I would say a positive set of results within that challenging environment.

Certainly, over the next six months you know, our focus would be totally concentrated if you will in completing you know, finalizing the Elefsis upgrade, which for us obviously as you can understand, is a transformational initiative.

As Andreas explained to you earlier on, it will, you know, dramatically change the cash flow generation profile of our Group. We will, you know, next as this is completed and it begins to operate and looking at the current diesel, fuel oil crack differential this will generate substantial additional cash flows for us next year and of course, our intention is for the next two years to be quite conservative in terms of CapEx. So we will become a significant cash flow generators as of next year and our profit profile and our cash flow profile would dramatically change.

So, completing that investment I guess by the end of this year you know, provide for the commissioning and the start up for next year is a fundamental top priority for us and that's what we are going to be focusing on. Of course, on a day-to-day basis we need to continue to manage within a very challenging environment.

I mean the good news which you heard from Andreas and me is that in terms of retail we are seeing you know, a major if you will slowdown in the rate of decline. I mean this is also partly due to a lot of initiatives on our side, you know, we launched new products in the market you know, we are managing our network much more tightly on the retail side and we've gained market share particularly on the EKO brand. So we will continue to do that.

Obviously with an eye on funding cash flow and a lot of attention on credit risks which is obviously is a top item for us, and I think we are doing very well on that front too. So, hopefully you know, all I have to say at this stage is that you know, renew our appointment for the review of third quarter results. Thank you very much for being with us this afternoon. And talk to you soon again. Goodbye. Thank you.