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"Second Quarter 2016 Financial Results" Conference Call

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Mr. Ioannis Psychogios, General Manager of Group Supply, Refining and Sales & BoD member
&
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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 Second Quarter 2016 Financial Results.

At this time I would like to turn the conference over to Mr. Grigoris Stergioulis, CEO, Mr. Andreas Shiamishis, CFO & BoD member, Mr. Ioannis Psychogios, General Manager of Group Supply, Refining and Sales & BoD member & Mr. Vasilis Tsaitas Investor Relations Officer.

Gentlemen, please go ahead.

STERGIOULIS G: Hello, ladies and gentlemen, my name is Grigoris Stergioulis, I am the CEO of Hellenic Petroleum and I am glad to give you a small Presentation of the Second Quarter of the Year Results for Hellenic Petroleum Group.

For the second quarter of the year, Hellenic Petroleum Group adjusted EBITDA amounted to €156 million against €130 million of the relevant period last year, as increased refining output and sales volumes outweighed the negative effect of weakened benchmark margins on profits. Improved optionality in crude oil supply and liquidity enabled additional benefits from commercial opportunities in crude pricing and mix optimization.

The recovery of international oil prices during the second quarter of the year is reflected in improved IFRS reported net income, which came in at €72 million against €49 million last year, an increase of 47%, while the first half of the year net income exceeded the €100 million, an increase of 17% improvement in Group net equity position and balance sheet.

Financial position further strengthened as a result of the repayment on the 16th of May of the current year of the €400 million dollars bond issued by HPF, and the successful harmonization process of covenants of the outstanding euro bonds and commercial bank term facilities. Interest expenses reported as 5% lower versus the second quarter of the year last year and the refinancing of outstanding bonds maturing in 2017 is in progress, a development that will lead to further reduction of financial cost.

Allow me to point out a few characteristics of the current working period which are: first, the positive results of all business units, second, the continuous adaption to domestic and international market conditions, third exploitation of all possible feedstock opportunities and last but not least, the continuous improvement of the refinery operation over performance.

Now, do allow me to pass you over to Mr. Shiamishis for a detailed analysis of sheets.

SHIAMISHIS A: Thank you very much, Grigoris. Good afternoon, ladies and gentlemen, thank you for joining our call. We will go through a presentation of the second quarter and the first half of the year results, and highlight the key developments for each of the business units. After that, we are more than happy to take any questions or comments you may have.

So, I will take the presentation page by page and I will refer to the page numbers as I go through the presentation. So starting with Page 2, we have the key highlights. As mentioned, we have a strong second quarter results, which is €156 million of adjusted EBITDA and that is driven effectively by first of all, a weaker environment compared to last year, but on the other hand, we have increased production as a result of the mechanical availability of the refineries, which has effectively more than compensated for the weaker refining environment. Increased production effectively led to a record high exports participation in our sales mix, which is up 60%. Over the last two quarters, if you recall, we were running at around 40% to 50% of the total sales being directed to our export markets.

As mentioned earlier, results are a result of a worse refining environment, a weaker refining environment, but higher production. But we need to mention that during the last three months, we have an improved performance by taking account of optimization opportunities where it comes from the crude supply optimization or the running of the units or the actual planning of the production of each refinery. That has helped to improve our reported results as well.

In terms of the IFRS numbers, clearly the increase of crude oil prices has reversed some of the losses that we reported in the last couple of years. The benefit is clearly a stronger balance sheet with respect to the IFRS reported numbers, but also a benefit with respect to cash flow, as we utilized part of the accumulated tax losses. And effectively, make use of the deferred tax, I think, that we had built because of the losses.

Cash flow remains strong with the metric of operating cash flow being the adjusted EBITDA less CAPEX at €133 million. I think it's probably the eighth or ninth quarter in a row which shows a robust cash flow performance, and is, if you will, a proof of concept for the new ELPE motto in terms of refining configuration.

Net debt is normalized at €1.7 billion, and that is also probably because of the payables normalization and working capital normalization and of course, it's a fact that we have already started making some payments to NIOC.

Finally, in terms of our financing, we have repaid the $400 million dollar Eurobond, as we said during the previous quarter conference call. The financial covenants have been successfully harmonized across all term loans and Eurobonds, and we are in the process of planning our actions for the refinancing of the 2017 Eurobond. Clearly, the Group is in a much better position than last year, and every quarter, we are in a position to report an improved performance and further strengthening of the Group's position.

Page 3 has the key numbers. I am not proposing to walk you through this page. So I will go to Page 5, which is the environment. Now on this page, we have a number of important external factors that affect our results. First of all, the slight recovery of crude oil prices which helped increase reported results, an average of 47 dollars per barrel being the Brent reference price. Clearly, we don't use Brent, but it is a relevant reference benchmark for us.

In terms of exchange rates, nothing important which would lead to a substantial change versus the previous quarters. So we move on to the bottom part of the page where we have two differentials being the WTI-Brent differential, the closing of this spread has helped European refiners overall and clearly that benefits us as well.

The other part of the equation which has to do with the Brent-Urals spreads also benefits Hellenic Petroleum, because we are in a position to process heavier crudes, thus taking advantage, hence the extra over performance over the benchmark by switching our crude slate to heavier crudes.

Going to Page 6, you can see the evolution of refining margins, of the benchmark margins, clearly a weaker environment as we mentioned earlier with the Aspropyrgos refinery being the FCC relevant benchmark at almost $3 dollars per barrel lower than last year, than second quarter 2015 and the Elefsina reference benchmark being almost a dollar lower than last year.

Page 7, we have the domestic market demand; relatively stable overall. We have a bit of anomaly in the comparison on the gasoline numbers given the capital controls enforcement at the end of last year, last June 2015. We expect that to reverse partly in the third quarter. In fact in July and August, we have seen some reversal of the 5% drop in gasoline consumption, but still, we are going through a weak domestic market. We don't expect to see significant recoveries.

Page 9, shows a high level bridge between the second quarter of 2015 and the second quarter of 2016, the actual adjusted numbers. We have the negative impact of lower refining margins; this is the key driver which is why we have simplified this chart. One has to bear in mind that the environment impact is somehow… is somewhat lower than what we would expect because in the second quarter of 2015, the production of the refineries was lower as well, because of the turnaround we had significantly lower throughput and production.

In a normalized quarter, the adverse impact of the environment would be around €60 million, so if we were comparing a normalized second quarter '15 environment, then one would expect to see a €60 million drop in the margins.

On the other hand, we do have the benefit of having the additional production and the higher mechanical utilization and availability of the refineries which gives us about €75 million of increased EBITDA. Again, it is a number which includes a number of smaller parameters, amongst others the over performance compared to last year's production profile, which is of the order of €15 million to €20 million for the second quarter. This is included as part of this big performance increase. And that brings us to the €156 million; those are the key numbers, if you will, that brings us to the €156 million of clean EBITDA for 2016 second quarter.

Page 10, we have a brief highlight of our credit facilities and liquidity. The key points, as we said earlier, the repayment of the Eurobond in May '16, the consent solicitation for the bonds in the term loans, a very healthy operating cash flow for the last 12 months of over €600 million which is pretty much in line with our projections and strategic plans. Clearly, we don't know whether this will last given that it's driven by the refining margins, but the volatility is significantly lower than what it has been in the past.

And overall, we have been able to reduce our interest costs, the gross interest expense by about 5%. We are not happy with that number; we expect that to go down even further, but clearly, this is not something that can take place instantly.

In terms of capacity, we put in place a standby facility of €240 million, part of it has already been drawn to provide additional headroom on any liability management and the financing process and that is something that we expect to rollout over the next quarter.

Moving on to the individual business units, Page 12, you see the numbers for the refining supply and trading, a strong set of results which is indicative of what the Group is capable of during the margin environment of 2016. In the second quarter, we were able to report about €100 million; that includes ordinary and normal unit shutdowns. We always have lower than a 100% run on a refinery, either because you may have a small unit unscheduled shutdown or because we may have catalyst change, so this is indicative of what one would expect in today's environment, if you project that by this just over €400 million coming from the refining supply and trading business on an annualized basis.

CAPEX is normalized; it's clearly lower than last year when we had the big turnaround. On an annual basis again I was to project, I would see sort of calling it around €16 million, €20 million of maintenance CAPEX plus small debottlenecking projects.

On Page 13, we show the quarterly production volumes for each refinery. And we also include some information about the crude sourcing and the yield of the system of the refineries. The big point to note is the diversification and the change in the crude oil mix. We have been able to take advantage of increased Iranian crude coming into the Med and of course the commencement of Iranian supplies in the Med, which we have used to optimize the crude mix aiming to get better netback per barrel and of course, a better absolute number in terms of performance.

Now as a result of the higher runs in the second quarter, we have higher sales given that the domestic market is constrained by its… by the current economic conditions, almost all of the increased production has found its way into export markets. And hence the 60% participation in total sales, which is a record for the Group, at least as far as I can recall the last 10 years that I have been with the Group.

Page 15, shows a very interesting performance in terms of how much we can extract per barrel of crude oil process and this is a result of the benchmark, the system and the benchmark margins, which is the bottom part of the bar, and the over performance which is anything between $0.25 and $1 depending on the specifics during that quarter. And the rest comes from the profits, the premium that we have on our sales.

As we see the increased participation of exports in our sales mix, one would expect this over performance element which comes from the trading premia to go down on a per unit basis. Clearly, on an absolute number if you multiply it by the number of barrel, numbers are better but there is a somewhat distorted view on a per barrel basis.

Page 16, we have the performance of our petrochemical business which is a vertical value chain integration with the refineries, a very decent performance given that margins have been, if you will, somewhat lower but we have been able to increase volumes. As I mentioned, this is a value chain integration, so increased production from Aspropyrgos, leads to increase availability of propylene, hence polypropylene and BOPP eventually, which effectively accounts for this increase even though we have lower margins in the second quarter of 2016.

Moving on to Page 18, we have the marketing business. First of all, the domestic marketing increase, which includes the two, networks of the ECO brand, the BP branded network and of course our commercial and industrial sales, our B-to-B sales and sales for aviation and bunkering. We have a somewhat lower performance than last year, but still a comparable performance. One would expect to see similar to last year full year results, and it's going to depend pretty much on the heating gas oil season which comes at the end of the year. If we have a stronger season then one might expect to see slightly improved numbers coming from our domestic marketing business.

In the international subsidiaries, we have again a small more deterioration of the profitability, mainly coming from Bulgaria where retail margins are lower than last year. Other than that, the other markets are pretty much in line with last year.

On Page 21, we have the key highlights for the Elpedison business which is not fully consolidated; it is treated as an equity, as an associate. So we have improved performance compared to last year. This is on account of two things. The first one has to do with lower nat gas prices which led to higher participation of nat gas fired units in the production mix of the country, and secondly the implementation of a temporary flexibility and capacity remuneration network. That has taken effect in May 2016. It will be in place for the year, and in between now and then, we expect to see a more permanent structure being put in place.

On the natural gas business, our 35% stake in the DEPA Group, we continue to consolidate 35% of the DEPA Group that includes DESFA. As you know, the DESFA sale is conditional upon certain approval processes… regulatory approval processes which are beyond our control, so until and unless those processes are completed, we are treating this as a 35% associate.

Performance in the DEPA group has been improved compared to last year on account of higher nat gas sales, which is, if you will, a direct result of the increase in the nat gas fired power plants, so we are reporting an improvement from the consolidation of 35% of the DEPA Group results in Hellenic Petroleum.

Now that brings us to the end of the business presentation. As we normally do, I will not go through the financial appendixes and the numbers and at this point in time, we have completed the presentation of the second quarter.

Thank you very much and it is over to you for any questions you may have.

Q&A

OPERATOR: The first question will come from the line of Kukhtanych Uriy of Berenberg. Please go ahead.

KUKHTANYCH U: Yes, good afternoon gentlemen. Thank you very much for the presentation. I just have one brief follow-on question on DESFA sale. It's… my impression was that in the beginning of the year, we already, all got the information that approvals from the authorities have been granted already, and now it looks like they are not.

So if you could briefly describe what are the conditions for these approvals, what is the timing for these approvals and what is the stance of SOCAR towards your transaction, is it still committed or is there any other body should be, which should be participating in the transaction? Thank you very much.

SHIAMISHIS A: Good afternoon Uriy, thank you very much for the question. Let me try and clarify the position with respect to the DESFA sale. The sale of DESFA was agreed as part of the tender process back in 2012. The conditions for having this transaction completed included clearance from the national relevant authorities, regulatory authorities and the European regulatory authorities. The approval from the Greek authorities was given, I think it was all completed back in 2013, and the whole process was referred to the European DG Energy and DG Comp for approval.

As far as we are concerned, until DG Comp, which is the only remaining part approves the structure of the transaction or instructs certain changes to the structure of the transaction, we cannot complete this process. Given the time it has taken, the sellers which is ourselves and the Privatization Fund the Hellenic Privatization Fund, TAIPED, as it is called in Greek and the buyer SOCAR have agreed to extend the long stop date for this SPA and also extend the provided guarantee as per the tender terms.

Now, the long stop date is in September 2016. We don’t know whether we will be able to complete the transaction by then. I would not like to comment on things which are not controlled by us. So as far as we are concerned we are still under the framework of the agreement and we expect to get clearance or instructions to change the agreement from the regulatory authorities. If such a case takes place and we will assess what changes are requested both ourselves and the buyers, and of course, we will act accordingly.

KUKHTANYCH U: Okay, thank you. Just a brief follow on, I understand that SOCAR is still the only participant in that transaction. Is that correct?

STERGIOULIS G: Yes, it is, yes it is.

KUKHTANYCH U: Okay and there is no requirement for another third party being present in the transaction?

STERGIOULIS G: Up to now, we have...

SHIAMISHIS A: Uriy, the… again, I will refer to facts; we have a share purchase, sell and purchase agreement, which is signed between TAIPED, Hellenic Petroleum as sellers and SOCAR as a buyer. Now, as far as we are concerned, SOCAR is the buyer. If DG Comp requests a change in the structure and we have seen a number of press releases coming out from various sources. That is something that we cannot comment on or confirm given that we do not control the process. So as far as we are concerned, the agreement is to sell to SOCAR and they will have to do whatever they need to do in order to make sure that the approval is obtained.

KUKHTANYCH U: Okay, thank you very much gentlemen. That's very helpful, thank you.

OPERATOR: The next question comes from the line of Mr. Patricot Henry of UBS. Please go ahead.

PATRICOT H: Yes. Hello, everyone. Thank you for the presentation, a couple of questions from me. The first one, you mentioned the increased exports during the quarter. Can you perhaps mention which export markets you are targeting, and what kind of trends you are seeing for demand in these markets? And then, secondly perhaps you could comment on your view for the… proper view on the refining margins for next few months? Thank you.

PSYCHOGIOS I: Okay. Good afternoon from my side also, I'm Ioannis Psychogios; trying to answer your question about the exports market…the export markets that we are selling the last quarter about 55% to 60% of our products. These markets are the same markets that we were aware selling and exporting all the previous year's which is mainly East Mediterranean markets, but also there are products that are heading to West; to West Europe, West Mediterranean and West Europe. Of course, we have our subsidiaries in the Balkans and in Cyprus, and we are sending products also in Black Sea area, and a lot of products in Albania and West Balkans Coast. So that's the markets we export… we export products.

As far as the refining margins, of course, the trading of the markets is trading now with much lower margins compared to the actuals margins that we see in the last period and general in August. So we expect that the refining margins we will… the refining margins will be strong as they are now in the last, let's say, 15 or 20 days. This will be helped by the maintenance period we are entering in September/October, and then okay it's too early to forecast what will happen later on.

Anyhow, our refiners are working; the two main refineries with high utilization and we do not expect to have any major maintenance or major turnaround, and also our small Salonika refinery is supposed… is planning to have a turnaround in November. So that's more or less what we expect for the rest of the year.

PATRICOT H: Okay. Thank you. And just one follow-up question that demand was a little bit better in Greece over July and August, is it something that you are seeing in the rest of the Mediterranean?

SHIAMISHIS A: Henry, can you repeat the question. The line was not very clear.

PATRICOT H: Yes, sorry. You said earlier that oil demand was doing a bit better in Greece over July and August, I was wondering if you are seeing the same trend in other markets in the Mediterranean?

SHIAMISHIS A: Yes, well in Greece it's a very special case because we have the abnormality of the capital controls in the domestic market. So yes, this year it is performing better and you also have to take into account the fact that we have increased tourists as well, which affects our domestic market.

In the other Mediterranean markets, I wouldn't be in a position to comment. We know the market that we have subsidiaries in. Cyprus is facing a similar position, increased volumes. Balkan markets I think it's pretty much stable as last year, nothing major to report to be honest. Other Mediterranean markets, we don't have information on the in-market sales to be able to comment, we have some sort of relevant quality if you will.

PATRICOT H: Okay, alright. Thank you.

OPERATOR: The next question comes from the line of Mr. Khaziev Ildar from HSBC. Please go ahead.

KHAZIEV I: Yes, hi. Thank you for the presentation. A couple of questions. First on the… on your crude mix. So we can see that the optimization came mostly at the expense of Urals crudes, so do you think further reduction would be beneficial in the current environment for you, and is there a scope for further changes? So this is the first question.

And second one is about the debt covenants; you mentioned in the press release, that there have been some harmonizations of covenants between the bonds and loans. So what exactly this is about? If you could comment that would be grateful. That'd be great. Thank you.

PSYCHOGIOS I: So about the Urals percentage, this is much lower compared to the last year. What we are trying to do here is to take the opportunity of the higher… of the heavier crudes that we have in the Mediterranean. Now we have the Iraqi crudes, we have the crudes from Iran, and of course, there is all the other heavy crudes in the East Mediterranean. We are trying to take… to get this opportunity to increase this, the percentage of these crudes.

Actually, what we are trying is to make some synthetic crudes making mixes between them, these heavy crudes and the CPC, and all of this basket is much cheaper for us, compared to a basket which is full of or with 5 percentage of Urals. So, this is the trend that we are going to continue and we are going to use the opportunities that we have to process these heavier crudes. Just to mention that our refineries both Aspropyrgos, Elefsina and Salonika are designed to operate with heavy crudes. So we try to take this opportunity and use these lower cost crudes for our feedstocks.

SHIAMISHIS A: Okay. On the second part of the question, with respect to the harmonization process for the debt covenants, the case is relatively simple. We had a number of different loan facilities be it Eurobonds or term facilities with commercial banks, which were put in place at different time periods and almost all of them, had reference to certain financial ratios, certain financial debt covenants. Unfortunately, because of the different time points that they were agreed and the historic evolution, each one had a slightly different definition of those financial ratios in the contract.

What we decided to do was to effectively clean the slate, get a common definition in all our contracts and in the Eurobonds and effectively, we took the opportunity to update it with certain developments that affect the calculation of these numbers. The three big items, which I can refer to was the treatment of tax losses on inventory devaluations.

We were taking a big hit on the net equity side because of the devaluation of stocks, which is an accounting devaluation. And at the same time, we were not taking any benefit for the tax element of that loss, which by the way, this year, next year is going to give us real cash, because we won't be paying the taxes.

So we included that in the definition, we fine-tuned the definition for the sale of the DEPA Group, which effectively refers to DESFA. Now, when we established this definition, we were running a tender process, sales process for both DEPA and DESFA.

And we changed some of the definitions in the calculation basis for our associates in the power generation and some intangible assets. So tightening up and harmonizing across the board effectively, which means that we have a clean slate and most likely, we will be able to utilize that for any future transactions as well.

KHAZIEV I: Thank you very much.

OPERATOR: The next question comes from the line of Mr. Aziz Kalim from Duet Asset Management. Please go ahead.

AZIZ K: Thank you. Apologies if you had already answered this question, I just wanted to clarify one thing, at the end of the first quarter, sorry, at the end of second quarter of this year, you had a total gross debt of… according to your slide, you have a net debt of €1.7 billion according to your slide, on slide 10 in the presentation, you have a gross debt overview, which says €3.1 billion. Could you clarify that? And could you also clarify the extent to which you have liability that you need to work out with respect to payment TIER 1? So, I need to understand what is the net debt position of Helpe and with respect including the debt to the banks as well as Iran; our Iranian liabilities. And what is the covenant limit that you have established across the board now, please? Thank you.

SHIAMISHIS A: Thank you very much, okay. I have got three parts of the question. Let's me try and answer them in sequence. The first one, which has to do with the net debt and the breakup terms of gross in debt and cash, as you already pointed out, we had about €1.7 billion of net debt as at the end of June. That is made up of term facilities and mainly… and some short-term and committed facilities of €3.1 billion. And we have a reasonably high cash balance of €1.4 billion. Now, that balance is effectively a result of a slightly more conservative approach than you would see in other markets.

Given that we are still not out of the woodwork in terms of the financing environment in Greece and the banking environment in Greece, so we have taken a very conscious decision as a Board to maintain the credit capacity near its maximum, near its limit and effectively allow cash to flat rate depending on working capital changes. Now, that has the negative carry cost of course, but the benefit of having this extra buffer in cash has been proven over and over again over the last few years. The last one was the capital controls in position in 2015.

However, as numbers improve and as the situation in Greece improves, you should expect to see a convergence of gross and net debt numbers. So if I was to project for the next 12 months, I would say that the cash balance is likely to be lower than a billion at the next supporting periods. Overall, the average run rate of net debt ranges between €1.5 billion and €2 billion depending on the prices, the amount of stock; we have increased our stock levels during the last few months, seasonality, September we tend to increase stock levels further because of the heating and gas oil season. So there will be some volatility in our cash balance.

Now, the other part of the question has to do with the level of covenants, we have in our Eurobonds, which is common now in our term loans as well, a level of net debt-to-EBIT to net equity of one. And as you can see, this is effectively something which is relatively safe in terms of going forward. I think those were the parts of the question.

AZIZ K: So, if I could ask again, so net debt to equities on… is there a net debt-to-EBITDA covenant at all?

SHIAMISHIS A: No, not in the Eurobonds or the commercial term loans.

AZIZ K: But, you said how much…? So there is no EBIT or you can leverage more than this or less than this on a net basis or a gross basis, there are any other covenants that should limit?

SHIAMISHIS A: No, net basis we are… our definitions always refer to net debt; gross debt is not part of the ratios.

AZIZ K: Okay, thank you. So in order for you to bring the debt, I mean there is obviously inventory fluctuation and seasonality in all that. So in order for you to bring the level of debt relative to the cash earnings powers of the Company, how many years… I mean what are the plans, what do you have in terms of a strategy? Or do you want to run with the net debt of €1.7 billion, €1.8 billion on the average for the next two, three years?

SHIAMISHIS A: I think that a Company of our nature and span of our activities, I should feel comfortable with a net debt to EBITDA of 2.5 to 3.5 times. So, somewhere in the strong investment grade ratio and a balance sheet gearing of anything between 30% and 40%, so those are the target ratios. With the numbers we have, we are not very far from that the target.

AZIZ K: Okay. So you want to keep the leverage at these levels, I guess?

SHIAMISHIS A: Within the couple of €100 million depending on fluctuations I think this is the appropriate level.

AZIZ K: Yes.

STERGIOULIS G: The thing which needs to come down and will come down is the cost of funding, which we expect that we will be able to reduce by a few tens of millions of Euros every year, if not more than that.

AZIZ K: Thank you very much. That's all I wanted to know. Thanks a lot.

OPERATOR: Excuse me, there are no more questions registered at this time, you may now proceed with your closing statements.

STERGIOULIS G: Okay. Ladies and gentlemen, thank for your attention, thank you for your fruitful questions. I think we had a good second quarter of the year, a very good first part of the year. And if the margins keep on going and our refineries keep on going, we will be glad to have the positive results against the next quarter, giving us the opportunity to see our future more and more optimistic. I'm sure you are following our activities, you are following our financial statements and we are glad to be in touch with you, anytime you may want as to provide with information you may need for your analysis. Thank you and have a good night.