



ERG S.p.A.
“Third Quarter 2010 Results”
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MODERATORS:

ALESSANDRO GARRONE, GROUP CEO

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PAOLO MERLI, CORPORATE FINANCE, CONTROL & INVESTOR RELATIONS

Operator:

Good afternoon. This is the Chorus Call Conference Operator. Welcome and thank you for joining ERG Third Quarter 2010 Results Conference Call. As a reminder, all participants are in listen-only mode. After the presentation, there will be an opportunity for you to ask questions. Should anyone need assistance during the conference call, they may signal an operator by pressing "*" and "0" on their telephone.

At this time, I would like to turn the conference over to Mr. Alessandro Garrone, CEO. Please go ahead, sir.

Alessandro Garrone:

Thanks. Good afternoon, ladies and gentlemen. Welcome to ERG third quarter and first nine months 2010 results. Here with me: Luca Bettonte, our General Manager, and Paolo Merli, our Head of Corporate Finance, Control and Investor Relations.

I'll start with the key financials for 3Q 2010 and the first nine months of the year. The Q3 adjusted EBITDA at replacement cost came in at €79 million, with an increase of €32 million - roughly 70% - compared to the €47 million over the same period last year. Please note that figures for the third quarter 2009 included €18 million of insurance reimbursement for the ISAB Energy incident.

The year-on-year growth has been mainly driven by a strong performance of the energy business, thanks to the full start-up of the CCGT as of April 1 and ISAB Energy as of May (ISAB Energy has started before scheduled), and despite weak results in refining activities, both in the coastal and inland refinery.

The third quarter net profit at replacement cost was at minus €14 million, in line year-on-year as higher depreciations, financial expenses and higher minorities absorbed the increased results at EBITDA level.

The nine months adjusted EBITDA at replacement cost was €213 million, compared to the €71 million last year. The growth was driven by similar trends over the period, which means a very good performance of the power business and a low performance in the refining business.

The nine months net profit at replacement cost was minus €13 million, with an improvement of €40 million compared to the same period last year. The reasons are the same, of course.

Looking at our balance sheet, the net financial position closed roughly at €1.3 billion at September end, compared to €662 million at 2009 year-end, and versus roughly €800 on June 2010.

The net financial position adjusted for 51% cash in ISAB balance sheet is at €1.25 billion. The leverage increased of course from 26% at 2009 year-end to 40% at the end of September. The strong increase in net debt in Q3 is mainly due to the acquisition of

the 102MW wind farm (with a total impact of €280 million on the net financial position), and also to a negative dynamic of working capital, which should be partially re-absorbed in Q4. Therefore we expect to close the year with a net financial position on an adjusted basis at the top of the range of our guidance, that was €1.1-1.2 billion.

Now, Luca will explain you better the financial position and, of course, all other results of our company. Thanks.

Luca Bettonte:

Good afternoon everybody, and thanks for coming. As usual, let me accompany you through our figures. Before doing that, let me remember you that we have merged ERG SpA with ERGMed and ERG Power & Gas (the two sub-holdings we had), and that the new organization is effective as of July 1. So we have adjusted the way we present you our figures according to the new organization we set up, that today is composed of refining & marketing division, power & gas division (whilst our activities in the renewables are carried out by our independent listed company, ERG Renew), and General Corporate Department at ERG SpA level.

Replacement cost EBITDA adjusted. On a quarter basis, it is €79 million versus €47 million, whilst on a nine-months basis it is €213 million versus €71 million: in both case, a very good and strong increase in our results. Then on year-on-year basis, the increase has been mainly driven by the strong performance of the power & gas, that has more than offset the lower results in coastal refining and integrated downstream, which were negatively affected by the worst scenario in this segments.

Going through our profit and loss, we have again a positive result if we compare EBIT value at replacement cost: on a quarterly basis, plus 13 versus minus 5, and on a nine-months basis plus 33 versus minus 80. Of course, we are very happy with these operating results.

Bottom line, net profit at replacement cost is minus 14 - flat on a quarterly basis - while we have again an improvement on a nine-months basis: minus 13 versus minus 52.

As usual, I think it's worth commenting this chart by focusing mainly on the net financial income and expenses. In terms of net income from equity, we had a lower result, because of Sarpom results this year. Last year we had a deal, and some items are affected by the change of the perimeter in terms of consolidation; in particular, the financial performance - in terms of net financial expenses - must be analyzed in details.

The number for the third quarter 2009 was minus 9 versus minus 19 this quarter, and on nine-months basis minus 9 versus minus 36. On a quarterly basis, the reasons are linked to an increase in the net debt (as you remember, we bought the 102MW wind farm) and the increase of the negative fair value valuation related to the IRS (Interest Rate Swaps) that we are using to hedge the impact of the potential negative trend for interest rates.

On a nine-months basis, last year we had some quite important positive results that we were not able to post in this year. They were firstly €10 million gain from Forex transaction (US dollars versus Euros), and €14 million financial income relating to the liquidity stemming from the transaction with LUKOIL. You will remember that last year LUKOIL had to pay us some amount of money for the delay we allowed them to have in the payment of the refinery, with a specific interest rate quite positive for us and the higher interest rate we gain on the liquidity after having cashed the amount from LUKOIL.

Minorities are another item affecting our net profit result: minorities are quite high in terms of amount, because most of our result in these first nine months is linked to the performance posted by the power & gas division. As you know, 49% of ISAB Energy is owned by a third-party. This is the reason why we posted such a result; in any case, from an operating viewpoint, let me underline we had a quite positive and an important growth.

Single business areas: after the consolidation through the numbers by business unit, we go as usual through the numbers of each of our subdivisions or sub-activities.

Coastal refining key figures: the adjusted replacement cost EBITDA was minus 18 versus minus 4 on a quarterly basis, and minus 28 versus minus 22 on a nine-months basis.

This result has been penalized by the worst scenario in this segment, both on a third quarter and nine-months basis: there is nothing particular to say in this context, scenario is not good and - as a result - that's what we posted in this slide.

To be more precise in terms of refining margin – again at replacement cost, US\$/bbl - let me comment just on a quarterly basis plus 0.72 US dollar per barrel versus plus 3.62, with the variance versus EMC down from 3.99 to 1.51.

In terms of unit refining margins, this lower result is a consequence of the weaker gasoline and fuel oil crack spreads. We had some positive signs from the Middle distillate cracks, but not enough to offset the general trend in the demand and in the value of the products.

Just a quick comment on volumes: they were higher in the third quarter this year, also because there has been an increase in the feedstock we provided for ISAB Energy, fully operating as of May this year. The premium versus EMC benchmark has been down, but in any case still positive thanks to higher middle distillate cracks we benefited from, as a result of the slate we used to produce.

Moving to the integrated downstream key figures, replacement cost EBITDA on a quarterly basis is plus 23 versus plus 39, and on a nine-months basis 62 versus 66. Looking at the breakdown just below this line on the chart, you see there's a strong result in marketing but a weak result in the inland refining and logistics.

Talking about marketing, looking at the third quarter figures, €37 million is a very solid result and in line with the performance we posted in the previous year, while for inland refining and logistics there is a negative performance on a quarterly basis: minus 14 versus a plus 1. There's a couple of specific items affecting this bad performance: let me remember you we had an upset at Sarpom refinery, negatively affecting such result. And we had a larger quantity of biodiesel blended this quarter, compared to last year, again affecting the cost effectiveness of this activity, and again higher costs for compulsory stock (the amount is €1 million), and some aspects related to inventory de-stocking with a positive impact in 2009 versus a re-building of such a stock in this quarter and in this year, so affecting negatively the result of the inland refining and logistics.

On a nine-months basis, with regard to inland refining and logistic the main reasons have been already explained to you, while from a marketing viewpoint, 83 versus 70 is a very good performance. Let me remember you that last year we incurred some €7 million to €8 million costs for the launch of ERG Mobile, and this year we benefit from the consolidation of Restiani, i.e. about €4 million.

From a marketing viewpoint, the retail market share is up (7.3 versus 7) on a quarterly basis, and again on a nine-months basis (7.3 versus 7.1). The wholesale market share on a nine-months basis is 8 versus 7.9. From a retail viewpoint, in general terms the domestic industry has shown in the third quarter an overall consumption down by 1%.

Our volumes were slightly higher, compared to the corresponding period last year, leading again also in this quarter to an increase in our market share; this is valid both on a third quarter and on nine-months basis.

Wholesale industry: domestic wholesale industry in the third quarter was in line with the same period, while on a nine-months basis the industry was down by 7%. In this environment, our market share was in line on a nine-months basis, and in any case the marketing performance has been good also in this quarter.

With regard to the performance of the inland refining activities, what I have disclosed to you before has led to a lower margin of US\$1.76 per barrel compared to 2.95 in the third quarter of last year. Volumes are pretty in line: the margin has been affected by what we commented before.

We move now to the power & gas division, starting with ISAB Energy key figures. We had posted very, very good results this quarter, and also on a nine-months basis: 1,099 versus 517Gwh sales on a quarterly basis, and on a nine-months basis 2,316 versus 1,473Gwh. Thanks also to slightly higher prices, this has led to a replacement cost EBITDA amounting to €47 million in the third quarter versus 18, and 123 versus 54 on a nine-months basis, while the net capacity utilization is up from 42% to 94%, and from 42% to 67% on a nine-months basis.

Prices were a bit higher, but it is important to underline that we doubled our production, thanks to the fact that the plant is again fully working very well as of May this year, one month ahead of schedule.

Moreover, the figures related to the third quarter 2009 included a reimbursement of €18 million, while we do not have any reimbursement this year: so again this underlines how good the performance of this plant was, as well as that of ERG Power & Gas and of ERG Power.

The plant has become fully operating since 1 April. The production has been very high: 834Gwh in the third quarter of this year (versus 111 last year), and 2,160 versus 348Gwh on a nine-months basis, with a very positive replacement cost EBITDA: 31 million versus minus 6 on a quarterly basis, and plus 63 versus minus 19 on a nine-months basis. So, the investment we finalized this year gave a very good contribution to the profitability of the Group, thanks also to the quantity, and to some benefit we can bring to our Company, having the plant located in Sicily.

In terms of electricity production, we have a very good and important increase also for renewables: 92Gwh produced and sold in the third quarter of this year, compared to 60 last year, and 285 versus 212 on a nine-months basis, with a replacement cost EBITDA flat (5 versus 5) on a quarterly basis, but growing (20 versus €14 million) on a nine-months basis.

We have had the positive contribution of the new wind farm bought this quarter (some €4 to €5 million), offset by some accruals relating to some - we hope - non-recurring items relating to the restoration of soil stability at Vicari wind farm in Sicily. On a nine-months basis, the performance has been very strong and the company is going to a very good shape.

Adjusted investments, on a quarterly basis, were €46 million versus €92 million, whilst on a nine-months basis €195 million versus €253 million. Investment are down year-on-year by 50%, mainly as a result of the phase out of the CapEx for re-powering. Investments are slightly higher just for renewables, the business segment we are investing in.

You will remember that we are working very hard to finalize in due course Fossa del Lupo and Ginestra. And on top of that, you should add the €280 million we spent in this quarter to buy the wind farm, ERG Eolica Adriatica.

On a nine-months basis the €71 million for power & gas relate to the completion of CCGT re-powering and to the reconstruction of train 1 of ISAB energy.

Last but not least, cash flow statement. We started the year with a net financial position of €662 million and a leverage of 26%, landed at €1.3 billion at the end of this quarter (€1.250 billion on adjusted basis, i.e. deducting the liquidity that is in ISAB Refinery, but pertaining to us).

In general terms, the increase in the net financial position is a result of the investments made in the period (€145 million), the acquisition of 102MWs wind farm (€280 million) and the increase in the net working capital (€177 million - later on I will comment in detail the reason of this increase). All these items - along with the €39 million as cash flow from operation, the dividend distribution (€65 million) plus tax payment - have led to such a result.

Talking about the increase in the net working capital, let me comment on a nine-months basis. The increase is due to some different reasons.

We had larger quantities of electricity produced and sold by ERG Power, a larger number of customers relating to the sale of electricity made by power & gas division, and the larger quantities of electricity produced and sold by ISAB Energy, back into full operation since May this year.

We had also an increase of renewables receivables due to the larger quantity of power produced and sold by the company, along with the payments of most portion of the large investments the company made in the last quarter of last year (about €42 million).

Analyzing what happened in the refining & marketing division, we posted an increase of oil inventory for ERG Petroli because of either the large quantity of stock associated with the Sarpom upset (some €50 million) and a large amount of stock build in preparation for the merger with Total Italia effective on the 1 of October. Of course, this increase of stock has been partially offset by an increase in trade payables; in any case, the net result has been an increase in the net working capital.

We had a specific trade payable trend at the end of the quarter for the coastal refining, due to the refinery planning and a stock build for coastal refinery that at the end of last year was at a very exceptional low level (250 kilotons versus 417 kilotons at the end of this quarter). Of course everything is under control under the budget objective for the refinery. The reason was that at the end of last year we were really at a very exceptional low level.

It is also important to remember that this increase from a general viewpoint also reflects the mistiming between the ISAB Energy insurance reimbursement against the property damage of about €127 million that we cashed in 2009, while an important portion of the CapEx for the reconstruction has been spent this year, in particular during the first half of the year.

Then there is the negative impact of the fair value of the interest rate swaps linked to the project financing. As you remember, we drew some €300 million for ERG Power plant and we brought home some €200 million project financing from the acquisition of the wind farm. That's the reason why we have this interest rate swap affecting our net financial position, even though you know better than I do that this is not a real debt at the end, but just an accounting impact.

Of course this increase in the net working capital on a nine-months basis has been affected also by the increase in this quarter, and the reasons of the increase in this quarter (approximately €200 million) have been again the Sarpom upset, the build-up of stock made by ERG Petroli, ahead of the merger with Total Italia, and the going back to the recurring inventory level for coastal refining.

Most of these effects should be considered as a one-off just across the quarter, so they should reverse by year-end. Then I can confirm what the CEO has already told you, i.e. that our forecast by year-end is in the upper side of the range we gave you couple of months ago. So €1.2 billion of net financial position or something more, on adjusted basis of course.

Let me just say that on adjusted basis, if you take €1.250 billion and deduct a €280 million from the acquisition of the wind farm, then on a like-for-like basis it should have been €970 million. So at the end I think that is quite kept under control and on a recurring basis for our business.

Having said that, I give back the microphone to our CEO.

Alessandro Garrone:

Thank you Luca. Just the last two slides on the economic guidance and some recent development in our strategy for 2010: in the guidance for refining & marketing business we see a result for 2010 similar from the one for 2009, but with different trends in the two businesses. The refining is still challenging: we do not see any increase in the refining margins, but we see a satisfactory performance in the marketing business, with higher market share and good margins.

For the power & gas business, we have a very good guidance for 2010 with the full contribution of the CCGT starting from the second quarter 2010, the full contribution of ISAB Energy starting from June, and good margins due to the fact that we benefit from our geographical position.

Also the guidance for renewables is positive, due to the contribution of the new asset, i.e. the 102MW we acquired, even if we still have some constraints from the maintenance work by Terna on the national grid.

Going to the last slide, let me just briefly go through the 2010 main achievements, which represent a good step forward in our multi-energy strategy. In the power business, all the assets are on stream: the performance of the completion of the two power plants was very good, and results so far are encouraging.

For the renewables business, the assets we have just acquired are very good in terms of quality, and they are performing well, so they will start to give cash to our company. Of course, we continue to work in order to expand our capacity both in Italy and abroad,

in line with our strategy. The Group restructuring is now effective. As of 1 July, we merged ERGMed and ERG Power & Gas into the holding company.

Last but not least, TotalErg - the joint venture with Total - became effective on 1 October this year. We are expecting very important synergies from this joint venture, and so far the management of the company is performing very well.

These are all the movement we have done in 2010, in line with our multi-energy strategy. Thanks for your attention. And now we are ready for your questions, thanks.

Questions & Answers

Operator:

Excuse me, this is the Chorus Call Conference Operator. We will now begin the questions and answers session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone. To remove yourself from the question queue, please press "*" then "2." Anyone who has a question may press "*" and "1" at this time. The first question is from James Schofield of Bank of America, Merrill Lynch. Please go ahead, sir.

James Schofield:

Good afternoon. Two questions, please. Firstly, I'll just ask the obvious question: next month is December, when do you intend to update the markets on your decision for the put option? And secondly, you have consistently been losing money in the inland refineries after the TotalErg JV: is there any chance you would look at closing Rome? Thank you.

Alessandro Garrone:

The first question: our decision on the put will not be influenced by investments on the renewables for the acquisition of the new wind power plant, or for future acquisitions. The put decision has to be taken with a different thinking, of course: we have to think industrially. As we always say, we would like to stay in the refining business, because we think we know how to manage this business. The put option is very flexible: we have a four-year time to take the decision, and we are working on that. But again, we must take a decision but not because we need money for the renewables expansion. Could you repeat the second question, please?

James Schofield:

Yes, just in terms of the inland refineries, obviously you have been losing money there for sometime. After the TotalErg joint venture, is there any chance you would look at closing any of those refineries, particularly the Rome refinery?

Alessandro Garrone:

I think it's still too early to say. Of course we are working with our partner in order to optimize all our assets, and the Rome refinery asset is one of the asset where we have to improve at least the results, rationalizing it in some way.

James Schofield:

Thank you.

Operator:

The next question is from Paolo Citi of Intermonte. Please go ahead, sir.

Paolo Citi:

Good afternoon. Two questions, if I may. The first one is on the coastal refining segment. I was trying to calculate your fixed costs in the quarter and, if my calculation is correct, it seems that they have been reduced to roughly €50 million for 100% of the refinery. So on the nine-month it is roughly €172 million down from €200 million last year. Can you confirm this calculation, and offer an indication for the fixed costs on a full-year basis? The second question is related to the acquisition of IVPC wind assets: you highlighted in your cash flow chart that the impact was €280 million. The cash out for the equity was roughly €224 million, if I am correct, so there are additional €60 million roughly of working capital. Is it possible to have some details on these, on what they are related to, inventories or receivables? In particular, do you expect that this working capital would be going forward? Because otherwise the cash multiples of the acquisition are much higher than €2.2 million per megawatt. Thanks.

Alessandro Garrone:

On the fixed costs of the refinery, basically we had a good reduction and savings in fixed costs. On a proportional basis, in the first nine months of 2010 the fixed costs were about €87 million, which means down by 14%, compared to the first nine months of 2009. This was really an excellent achievement for ISAB refinery, we have worked a lot on that with the so-called Spring Project to improve the efficiency of the refinery. So we can confirm the trend year-on-year on a full-year basis. For 2011 this trend will continue, not so strongly of course, but we still see room for costs cutting, even though much less than the one we have seen for 2010, because the Spring Project will end in 2011/beginning of 2012. But again, very good results: at the end we will see roughly 10% of reduction in fixed costs in 2010 on a full-year basis, compared to last year. On the second question: the total debt for the acquisition was 280 compared to 224 which is the correct amount excluding working capital and other accounting items. The difference in fact between these two figures is roughly €56 million, of which partly is working capital, and includes roughly €20 million of VAT credit and €6 million of accumulated green certificates relating to the production until July, the date of acquisition; and part is due to a negative fair value of interest rate swaps accounted in the net financial position of about €30 million, but this is an accounting figure and not a cash figure.

Paolo Citi:

Thank you.

Alessandro Garrone:

Thanks.

Operator:

The next question is from Lydia Rainforth of Barclays. Please go ahead, madam.

Lydia Rainforth:

Thanks and good afternoon gentlemen. I have two questions, please. Firstly, the guidance that you are giving for the marketing business for 2010 is so similar to that for 2009. Does that actually include the TotalErg JV to the fourth quarter? And then secondly, if I can go back to the put option, can you just explain to us the process you are going through in deciding whether to exercise that option on the 1 of December and, if you do not do it immediately, how often will you review that decision: will it be once a quarter? Will it be once a year? Could you just give us more details on how you are looking at that? Thank you.

Alessandro Garrone:

On the first question, the guidance I gave for all 2010 includes the 51% of the TotalErg results for the fourth quarter, so our *pro-quota* results for the fourth quarter. On the put decision, we are always working on that process. December is the first month when we may decide something. We have flexibility, even if we do not want to take all the flexibility we have (which means the four years), but at the moment I cannot say exactly when we will decide.

Lydia Rainforth:

Okay, I understand. Thank you very much.

Operator:

As a reminder, if you wish to register for questions, please press “*” and “1” on your telephone “*” and “1.” Once again for your questions “*” and “1” on your telephone, “*” and “1.” Mr. Garrone, at the moment there are no questions registered.

Alessandro Garrone:

Just to be more precise on Lydia’s question, technically we can notify the exercise of the put everyday, as we have no windows on the put: it’s really a flexible instrument.

So if there are no questions, thanks everybody; the next webcast will be for the full-year results. Goodbye.