ERG S.p.A.

"Second Quarter 2010 Results"

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MODERATORS: ALESSANDRO GARRONE, GROUP CEO
LUCA BETTONTE, GENERAL MANAGER
PAOLO MERLI, CORPORATE FINANCE & INVESTOR RELATIONS

Operator:
Good afternoon. This is the Chorus Call Conference Operator. Welcome, and thank you for joining the ERG Second Quarter 2010 Results Conference Call. After the presentation, there will be an opportunity to ask a question. At this time, I would like to turn the conference over to Mr. Alessandro Garrone, Chief Executive Officer of ERG. Please go ahead sir.

Alessandro Garrone:
Thank you and good afternoon everybody. Welcome to our first half and second quarter results conference call. I'm here with Luca Bettonte, our General Manager, and Paolo Merli, our Head of Corporate Finance and Investor Relations.

The first slide is about the highlights of the second quarter and first half 2010. As you can see, the Q2 adjusted EBITDA at replacement cost came in at €84 million, seven time up compared to the €12 million over the same period last year. These figures include €18 million of insurance reimbursement for the ISAB Energy incident - slightly more than the €16 million in Q2 last year - and include also €12 million of receivable write-off in the gas and power business in Q2 2010.

The year-on-year growth has been mainly driven by a solid performance of the energy business, thanks to the full start-up of the CCGT as of April, 1 this year and ISAB Energy as of May, before scheduled. This along with improvements, compared to the same period last year, of integrated downstream and renewable businesses.

Replacement cost net profit was up at €17 million, compared to a loss of €18 million in Q2 2009. Bottom line the improvement at the EBITDA is even greater, thanks also to the fiscal benefits as a result of the application of the Tremonti-ter Law, which provides for deductibility of some development investments done in the first half of 2010.

The first half results are strongly up year-on-year, and the drivers are the same as in the second quarter 2010: we had €135 million versus €24 million last year.

Looking at our balance sheet, the net financial position closed at €796 million at June end, compared to €662 million at 2009 year-end and versus €756 million in March 2010. The net financial position adjusted - if you consider the 51% cash in ISAB balance sheet - is at €751 million. The leverage increased a little bit: it's at 29%, but it is still very solid.

Now over to Luca, who will take you through the detailed second quarter results. Thank you.

Luca Bettonte:
Good afternoon everybody, and thanks for coming. We are going through our main figures of profit and loss and net indebtedness. At consolidated level, adjusted replacement cost EBITDA 2Q '10 is €84 million versus €12 million in the same period of last year, while on half-year basis we posted €135 million versus €24 million. So, results improved by far in all our business lines.

Power and gas reported stronger results compared to the same period last year, mainly thanks to higher volumes and prices for both ISAB Energy and ERG Power. Let me remind you that these figures include a provision for debt of approximately €12 million, mainly associated with the start-up of the power and gas business.

We posted also a solid performance from a marketing perspective within the integrated downstream, driven by higher market share and favorable market environment to a certain extent, while costal refining is flat year-on-year, but a bit improving.

Renewables are slightly up year-on-year: the results of this company reflect also some non-recurring costs related to a recent acquisition of assets.

Going down to the profit and loss, on a half-on-half basis, EBIT at replacement cost is a plus 20 this half versus minus 74 while, on Q-on-Q basis, it's a plus 25 versus minus 39. This is again a very good result.

As usual, I have some comments for your benefit just on a couple of lines below EBIT at replacement cost. First of all, non-characteristic items: this year 0, last year 35 which were mainly related to the reimbursement for the damage we incurred in the incident to ISAB Energy a couple of years ago.

And then, net financial income and expenses: Q-on-Q basis they are flat, but it's worth commenting what happened on half-year basis, i.e. minus 17 this year versus 0 last year. In general terms, cost for money has been lower, thanks to lower interest rates even though applied to a bit higher average net financial position in the first half. Last year we benefited from two extraordinary items. First, the interest owned by LUKOIL (you remember that at that time LUKOIL has still to pay €800 million, so we benefited from the interest on such amount, even if just for the first two months of the year) and some positive exchange rate we had last year. That explains the difference: crossing out these two effects, the amount of net financial income and expenses in 1H 2010 would be the same as in 1H 2009.

At the end, bottom line net profit at replacement cost is plus 2 versus minus 38 half-on-half basis, and plus 17 versus minus 18 on Q-on-Q basis. As a last comment, it is important to underline the positive impact of the application of Tremonti-ter Law on taxation, that allowed to deduct from the taxable income the amount of investments made over a certain period of time. The amount is about €14 million.

Let's go now through the numbers, right into the single divisions: coastal refining adjusted replacement cost EBITDA Q-on-Q is 5 versus 5, half-on-half minus 10 versus minus 19. Simple and quick comment: operating results were still under pressure during the quarter. The trading environment is still challenging, and that explains most of the reason for this performance; in any case, flat on quarterly basis and a bit improved on half-on-half basis.

More in detail, talking about refining margin at replacement cost: in terms of US dollar per barrel Q-on-Q basis, the figure is 3.68 versus 3.86. In dollar per barrel the result of this quarter is slightly lower than that of the second quarter of last year, mainly as a consequence of weaker gasoline and fuel oil crack spreads compared to the previous year.

In terms of middle distillate cracks, they have been a bit better, but yet not satisfactory: that's the reason why we posted such a performance. In any case, the variance versus EMC benchmark is still positive and important. In terms of volumes, we had approximately the same volumes as those of the previous year.

Coming to the integrated downstream, replacement cost EBITDA Q-on-Q is 24 versus 10, whilst half-on-half it is 39 versus 27: good results again. On a quarterly basis, marketing overall EBITDA has been much stronger this quarter compared to the same quarter of last year, as a result of a solid performance of our retail and wholesale segment. Let me remind you that last year we had incurred about €6 million costs relating to the launch of ERG Mobile Project, so the comparison has to take into account this amount. In terms of inland refining and logistics, EBITDA has been better than the same quarter of the previous year, thanks to the positive performance of Sarpom refinery.

Talking about quantities, let me mention the market shares: when you look at the Q-on-Q comparison, the retail market share is 7.3 versus 7.1, whilst the wholesale market share (gasoil in particular) is 7.5 versus 7.2. So marketing performance has been better than the industry trends.

The domestic industry has shown in the second quarter of 2010 overall consumptions minus 2% compared to the same quarter of last year. ERG volumes were slightly higher compared to the corresponding period last year, leading to an increase in the market share. Wholesale industry has been down even more, by 7%, and also in this case our performance has been better, so our market share increased. And thanks to the profitable market environment, also profitability has been satisfactory.

Furthermore, inland refining margin at replacement cost dollar per barrel is 3.20 versus 0.33, looking at the Q-on-Q comparison. In terms of volumes: 570 kilotons this quarter compared to 693 kilotons in the same period of the previous year. Again, margins in the second quarter were considerably up compared to the same period of last year, due again to a stronger performance of Sarpom. Volumes instead were a bit down, because we had the refinery turnaround during the second quarter this year at Rome Refinery.

Moving now to the energy: ISAB Energy, sales in gigawatt hours are 709 versus 485 Q-on-Q, and 1,216 versus 956 half-on-half. On a quarterly basis the higher production is due to higher load factor (62% versus 42%) accompanied by higher tariffs of around 10%. That has led to a replacement cost EBITDA at 37 versus 12 Q-on-Q, and at 76 versus 36 half-on-half.

So: good performance, good prices, higher volumes, higher load factors, and also the plant came on stream in mid-May, well ahead of schedule: everything is positive with respect to ISAB Energy, and we are very happy after a strong job made by everybody in the company.

Now, ERG Power and Gas and ERG Power. Electricity production in gigawatt hours is 783 versus 117 gigawatt hours, with the replacement cost EBITDA improved significantly in both Q-on-Q comparison and half-on-half basis. Production was strongly up year-on-year, fully benefiting from the new CCGT which was in commercial operations throughout the entire quarter. And, despite a tough CCGT general trading environment in the country, the location of ERG Power has allowed the company to post very high and positive results.

Renewables: just a quick recall, after the conference call held yesterday by the company. Electricity production in gigawatt hours is 84 versus 68 Q-on-Q, and 193 versus 153 half-on-half, so a very good performance. And you can see that also the replacement cost EBITDA level is up: 5 millions versus 4 Q-on-Q, 15 versus 9 half-on-half.

The improved EBITDA is due to higher production both in France and in Italy, benefiting from the full contribution of the new wind farms (Vicari and Faeto) and also thanks to the decrease of Terna grid limitations on some wind farms, and stronger winds in France.

Prices were slightly up year-on-year on a quarterly basis, while slightly down during the first half. In any case, it has been the second positive quarter in a raw - also at a bottom line - for our renewable company. So the positive trend continues.

Investments: on a Q-on-Q €71 million in the second quarter 2010 versus €99 million in the second quarter 2009 (down 28% on a year-on-year basis), as a result of the phase out of CapEx for re-powering. Investments done in power are related to the reconstruction of the train #1 damaged in October 2008.

In the renewable sector the increase of investments to €16 million is mainly related to the construction of Ginestra and Plogastel wind farms in France.

Let’s see now our net indebtedness from a cash view point: we started with the 662 million with a leverage of 26% at the beginning of the period, and we land in the 796 with a 29% leverage at the end of June. On adjusted basis - so including the cash pertaining to us but located in ISAB S.r.l. - the net debt is €751 million. The reason of this increase, that we of course were expecting, is that we invested €108 million, we had distributed €65 million of dividends and of course, we posted a poor operating cash flow and this is the reason of this increase, mainly due to CapEx and dividends.

Leverage 29%: again a solid financial structure and position for the Group. And now I'll give back the line to our CEO.

Alessandro Garrone:
Thank you Luca. I will comment the last two slides on some economic guidance for 2010, and the step of the strategy of the group.

For the economic guidance, as far as coastal refining is concerned, for 2010 we see slightly better overall results compared with 2009 for two reasons. The first one is that we don't have any general shutdown scheduled for this year (we had a shutdown in the first half of last year for one part of the refinery), and the second one is that in terms of margin we see a small recovery compared to the previous year, even if the environment is still challenging in this sector.

For the integrated downstream, considering the existing perimeter and not the joint venture with Total, also here we see slightly better results (if compared with 2009, with increasing retail sales and market share, even if the margins will be a little bit lower), and lower costs, as Luca said, associated with the ERG Mobile project. The scenario for inland refineries is still tough.

For the thermoelectric, we see again very good results: in line with the first half, with the full contribution of the new CCGT as of the beginning of the second quarter 2010, full contribution of ISAB Energy as of June 2010, and a production of about 6 terawatt hours, half for ISAB Energy and half for the CCGT.

Renewables: better, thanks to the contribution of the new quality assets we acquired (102 megawatt in August this year), plus of course an increase in production as a result of the new installed capacity. We still see some constraints in terms of maintenance work on the national grid by Terna, but in general we see positive results.

The last slide is on the developments we had in our strategy, in a chronological order. For the power business, we have already said that both the two plants - CCGT and ISAB Energy - are performing very well. So they will contribute very well in our results.

As far as the joint venture in the downstream is concerned, in May the Antitrust gave the green light for the joint venture, so TotalERG will become effective as of October, 1 of this year, as scheduled. We are of course working together to define the industrial plan, from which we will see the benefit in terms of costs and synergies of this joint venture.

With reference to renewables, we have announced at the end of June the acquisition of the 102 megawatt high-quality assets in Italy: this will add cash flow and critical mass to our operations, in line of course with our strategic objectives. An internal task force is working hard on this field, with the aim to continue expansion by building up a well balanced and geographically diversified portfolio. Of course this is also to mitigate the regulatory risks in this business.

Finally, the Group restructuring is going on. As of July, 1 our two sub-holding companies - ERGMed and ERG Power and Gas - have been merged into ERG, and the new organization based on two business units - oil and power - became effective. So we expect good savings from this reorganization and a speeding up in our decision making process. I think that all these moves together are providing the Group with a really better strategic position, so that we are ready to take opportunities in the years to come.

Thanks for your attention, we are now ready to take your questions.

Questions & Answers

Operator:
Excuse me. This is the Chorus Call conference operator. We will now begin the questions and answers session. The first question is from Mr. Paolo Citi of Intermonte. Please go ahead.

Paolo Citi:
Good afternoon everyone, I have just two questions. The first one is related to your expansion strategy, particularly in the renewable sector and the wind sector: you mentioned a JV with LUKOIL in order to exploit potential opportunities. I'd like to have some more colour on this if possible. Then, related to this potential expansion I was trying to make some calculation regarding your financial structure and evolution. In particular, starting from your current net debt and taking into account also the additional 220 million cash-out for the new wind plants you acquired recently in Italy, it is likely that your net debt at year-end would exceed €1 billion again, while the EBITDA could be roughly in the region of €300 million, assuming your scenario I think. In this case we would have a net debt EBITDA ratio in excess of three times. So my question is: do you think it is possible with this financial structure to further expand or invest significantly in renewables, and is this possible also maintaining your current stake in the refining sector, or are you considering a potential exit from the refining segment? My second question is related to the CIP6: we've read just a few days ago about the signature by Mr. Berlusconi of a decree setting details for the resolution of the CIP6 contract. I'd like to have some details and your view on this.

Alessandro Garrone:
On the agreement we have announced with LUKOIL: we are starting with a joint working group to analyze countries where also LUKOIL has an industrial presence, to see if we have opportunities to develop wind power generation together. We have an experience in the wind power generation, they have an important presence in some countries: so we are just beginning to study the situation, in line with our idea to develop renewable business also abroad. Of course, if we have a good partner to help us expand, I think it's a very good opportunity. The idea is to analyze the situation in some countries: Russia and some Eastern countries, like Romania and Bulgaria mainly. We have just started to analyze this together, so we don't have any specific project at the moment.

In terms of ratio net debt on EBITDA, we expect to have a net financial position at about €1.1-1.2 billion by the end of this year; of course this includes the acquisition of the 102 megawatt wind farm, but if you compare it with the EBITDA, by the end of the year the ratio should be within the range 3.0 – 4.0 times. Of course, to consider our investment in the future, we have also to look at the trend of the EBITDA in the medium term; so I think this ratio will become better. I also underline that on the total debt we have more than €700 million of project financing non-recourse: so the ratio has to consider also that more than 50% of the debt is project financing non-recourse. For both these reasons, I think we still have room to invest capital in our businesses.

About the CIP6, the recent decree has defined parameters for the reimbursement. This concerns only the gas-fired plants for a total amount of 2,000 megawatt, and of course those power plants will be entitled to adhere on a voluntary basis on the proposal. So our plan - together with others similar to ours - is not included in this decree, and we think it should be subject to a separate decree: if this separate decree arrives, of course we will evaluate if we want to adhere or not at this scheme.

Paolo Citi:
Thank you very much.

Operator:
The next question is from Ms. Lydia Rainforth of Barclays Capital. Please go ahead.

Lydia Rainforth:
Thank you, and good afternoon gentlemen. I have two questions, if I could. Firstly, can you just clarify on the tax rate for me? I think I missed out as to why the tax rate seems so low in the quarter. And secondly, can you just walk us through in terms of the LUKOIL joint venture? What are the benefits you are actually seeing from the costs side, and can you tell us whether you've seen any improvement in the operations of the underlying refining business? Thank you.

Luca Bettonte:
Tax rate is a bit strange this quarter and this half, because we have benefited from the specific law, the so called Tremonti-Ter Law, that allowed the company to deduct from the taxable income the amount of certain investments, i.e. CapEx, made over a specific period of time: that allowed the company to save money from a tax view point. The positive impact is €14 million on half-year basis.

Alessandro Garrone:
The second question is on our joint venture with LUKOIL. We are working very well together in terms of operations to manage the refinery. We have launched together an important project in term of costs reduction and efficiency, both on the fixed costs and energy costs. And we already see the results: in fact, the fixed costs for the first half 2010 were 9% lower year-on-year, and we expect to confirm this year-on-year trend on a full-year basis. I think this is already a good results of the project that we called the Sprint project, aiming at a good joint management of the refinery.

Lydia Rainforth:
Thank you very much.

Operator:
The next question is from Mr. Domenico Ghilotti of Equita SIM. Please go ahead.

Domenico Ghilotti:
Good afternoon. I have three questions, the first is an elaboration on the savings that you are expecting in refining: I would like to understand if you see further savings in 2011, after this achievement in 2010. The second question is on the Nuce Nord contribution: can you guide a little bit more on the contribution for the full year? And the third question is related to the put option with LUKOIL: in a recent interview you stated that you could also consider to exercise the put option in installments, so could you elaborate a little bit on this potential outcome?

Alessandro Garrone:
About savings related to fixed costs of the refinery, we have just launched the project but with good results: 9% reduction over first half 2010. At regime, which will be reached in a couple of years, we expect savings and costs to be roughly between €30 million and €40 million per year versus 2009 costs.

Domenico Ghilotti:
Sorry I didn’t catch the figures…

Paolo Merli:
Between €30 and €40 million.

Domenico Ghilotti:
Okay, thank you.

Alessandro Garrone:
The second question, can you…

Domenico Ghilotti:
Nuce Nord contribution: can you give a more detailed guidance on contribution because you had a start-up at full commercial capacity and it would be interesting to understand what is the full-year 2010 profitability.

Alessandro Garrone:
For the second half of the year we expect a contribution slightly better compared to the first half, when we had €32 million.

Domenico Ghilotti:
Okay.

Alessandro Garrone:
The last question was on the put: in my interview I didn't say that. Of course we can exercise the put in different installments, as the contract would allow us to, but that doesn't mean that we want to do that. So that was the interpretation of the journalist, but again: we have the right to exercise the put, it is quite obvious that we continue to monitor the market to assess the embedded value of this right and then to take the decision. But I remind you that we have a four-year time, starting from December 2010. We are really working on that even if in the general strategy we still consider the refining business a good business to be in, in the medium-long term. So there was nothing really new compared to my previous statements.

Domenico Ghilotti:
Okay, thank you.

Alessandro Garrone:
Thank you.

Operator:
There are no more questions registered at this time.

Alessandro Garrone:
Okay. So thank you everybody for the attention. Have a nice summer, we will see you back again in the autumn. Thank you. Bye-bye.