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"Full Year 2015 Financial Results" Conference Call

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Mr. George Alexopoulos, General Manager Strategic Planning & Development
Mr Ioannis Psychogios, Refining Supply & Trading General Manager & BoD Member and Mr. Vasilis Tsaitas, Investor Relations Officer

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 Full Year 2015 Financial Results Conference Call.

At this time, I would like to turn the conference over to Mr. Grigoris Stergioulis, CEO, Mr. Andreas Shiamishis, CFO & BoD Member, Mr. George Alexopoulos, General Manager Strategic Planning & Development, Mr Ioannis Psychogios, Refining Supply & Trading General Manager & BoD Member and Mr. Vasilis Tsaitas, Investor Relations Officer.

Gentlemen, please go ahead.

STERGIOULIS G: Welcome everybody. My name is Gregory Stergioulis; I am the CEO of Hellenic Petroleum. And I would like to introduce you to our team around me that will be available to you for any kind of questions whatever.

What a year. On May the 8th a major accident, with two of our refineries in extended shutdown, then the capital controls, the political instability in the country described the challenges and the environment we had to operate. Despite all these, Hellenic Petroleum Group reported another strong quarter for the year 2015, with full year adjusted EBITDA reaching €758 million, the highest on record while adjusted net income amounted to €268 million with improved performance from all business units. However, Refining, Supply and Trading was the key driver by not only managing to capture the favorable international refinery environment, but also to achieve a record high over performance.

Marketing companies in Greece increased sales and profitability as transformation program KORYFI and competitiveness improvements reduced fixed costs and supportive commercial operations. International subsidiaries also recorded improved results on the back of synergies with refining improved local market conditions.

Petrochemicals benefited from increased vertical integration following recent investments which combined with improved margins led to a record high profitability.

Sales revenue and reported results were affected by the decline of crude oil prices for a second consecutive year with inventory losses exceeding €300 million against €484 million last year. Despite the challenging economic environment, Group's financial cost were reduced by 7% following the Eurobond issuance in 2014, while net income came to €45 million for the year.

Positive results strengthened the Group's financial position, allowing it to overcome the challenge in domestic environment during the year, as well as to take advantage of opportunities in the market, contango trades, alternative supply crude sources.

Last but not least, allow me to notice that the Company's ability to continuously adapt to changing conditions, both in the local and international markets proved the robustness of the Company's strength.

Thank you so much. Now please for a detailed explanation of the results, I pass you to Mr. Andreas, Shiamishis. Andreas…

SHIAMISHIS A: Thank you very much, Gregory. Good afternoon everybody. Clearly, it's a pleasure to have you on one of our conference calls again and it's particularly pleasant to be able to go through a very strong set of results with you, in fact the best results we've published on an annual basis at least as long as I've been with the Group.

So going to Page 2 where we have the key highlights for the fourth quarter, with a bit of information on the full year. €184 million of adjusted EBITDA for the quarter and €758 million for the year. This is despite the fact that we had, as Gregory mentioned, an extended shutdown period in the second quarter of 2015 extending a little bit into the third quarter as well. So it's clear that the business has performed very well. We have been able to capture the opportunities and we are pleased to be able to report such a strong set of results.

In terms of key drivers, we have the strong benchmark margins and a relatively stronger than last year dollar exchange rate compared to euro, but all of this clearly make sense only if you have your refineries operating in good shape, and you take advantage of the opportunities in the market.

So post the turnaround in the second quarter of '15, we have been able to gradually ramp up the refineries by the end of the year and capture the very positive environment. In fact, in the fourth quarter we reported record sales of just over 4 million tons with over 50% of that being directed into international markets.

Unfortunately, we did suffer the loss on the inventory, which is a result of the continuous decline of crude oil prices. So on the back of enormous half a billion write-down of inventory in 2014, we have reported another €300 million of inventory write downs and clearly that is something which we cannot avoid, given that with our market share which is anything between 60% and 65% of the domestic market, we have to carry the respective compulsory stocks, the strategic stock reserve for the Greek market.

In terms of operating cash flow, we are out of the high investment period of the previous years, which is why our cash flow generation is under…just under €600 million. And if you take out the interest payments, the financing cost of about €200 million, then we have a very strong free cash flow, which allows us to build our cash reserves and to strengthen the balance sheet of the Group.

In terms of an important development just after the end of the year, we could not but refer to the framework agreement with NIOC, which effectively has two legs, the first one is the recommencement of crude purchases which we've stopped back in early 2012 as a result of the sanctions, as well as a very reasonable settlement profile for the same or the old invoices that were, if you will, frozen back in 2011 and 2012. So it de-risks the balance sheet because it sort of puts a very reasonable time scale in terms of repaying, and also opens up another important opportunity for the supply of crude to the Group, which we will make good use in due course.

Needless to say that this we have been doing all along, we will continue to ensure that the implementation of this agreement with NIOC will be in full compliance of all the international and European framework for trading with Iran.

In terms of what's coming up in the next few months, we have a repayment of a $400 million Eurobond which we plan to repay from our own existing cash reserves, and our plans include a possible new transaction towards the end of the year, once markets normalize which will improve even further our balance sheet.

Finally in terms of the summary of key developments, we should mention the award of the exploration rights for two additional areas in Western Greece, early days, but we are very excited about the prospects. And of course, the completion of the first phase of the Geophysical studies in West Patraikos, which was awarded a while ago.

Moving on to Page 3, we have a summary of the key numbers. You can see that…I won't go through all the numbers in this page, but you can see that we've reported higher sales volume in refining and marketing. Net sales of course is affected by the average price of crude. So that justifies the decrease in the top-line. And as you can see, we are reporting improved performance pretty much on every single business unit in the Group.

The star of the show is Refining, Supply and Trading, which more than doubled the performance, but we should not overlook the strong performance from the other parts of the Group, which if I may add, is actually more difficult to achieve as well given that a lot of the drivers there have little impact. So there is a lot of effort to achieve this improvement.

Finance costs are down by 7%, not as much as we would like it to be, but with the environment in Greece and the financial markets turmoil, I think this is a positive thing to report.

In terms of CAPEX, the shutdown pushed up the capital expenditure for 2015 to €165 million, slightly up on a normalized capital expenditure plan. And our net debt is at a similar level to 2014.

Moving on to Page 5, spending a couple of pages on the industry environment, I will be commenting on the issues which affect us rather than the overall markets. So the sharp decline in crude oil prices which on average…dollar for the Brent benchmark for the fourth quarter and actually lower for January as well, have led to an inventory write down in our books at the end of 2015. The stability and the relatively strong levels of the dollar compared to euro have helped to report an improved margin compared to last year. And of course, the crude differentials, the Brent WTI as well as the sweet-sour spreads have been benefiting our performance as well.

This is probably more visible on Page 6 with the refining margins where we have on the right hand side the two key benchmarks for the Aspropyrgos refinery which is the FCC and the Elefsina refinery which is at the bottom of the page, healthy margins throughout the year, on average about 6.5 for both of them, which is almost $3 per barrel higher than last year. And you can see the individual product cracks on the left hand side of the page.

Now moving on to Page 7, a key driver of our commercial performance stems from our sales in the domestic market. In 2015, we saw an increase of about 6% to 7% overall as a market. This excludes sales to PPC and armed forces because they are not considered to be a good proxy for the consumption in the domestic market. And you can see that the key driver is actually the heating gasoil increase which is up by more than 40% compared to last year. That it's clearly on account of weather and a lower price point overall.

Moving on to Page 9, 9 and 10 tries to depict the causal track between 2014 and 2015 results, the first one for the quarter and the second one for the full year. So we've broken down the main elements of the differentiation in the performance. If you think of our numbers, we have effectively the contribution of the refineries at the benchmark level, so that is entirely driven by benchmark margins. Then we have an over performance which is effectively the realized margin compared to the benchmark. We have trading premium and that effectively covers the refining supply and trading element of the contribution, which is just to remind you for the full year, it's €560 million of EBITDA.

Then we have marketing which is about €100 million and petrochemicals which is about €100 million, €93 million to be exact for 2015. That is on Page 10 by the way.

So this bridge explains how we go from 2014 performance of €417 million for the adjusted EBITDA to €758 million, which is 2015.

It's clear that the environment has been quite instrumental in getting to that number. We've got €350 million almost of benchmark margins and foreign exchange. A bit of a give away because of the capital controls and the Greek crisis during 2015. And on the right hand side of the page, we have what is probably more controllable as elements…. as drivers in our performance.

The shutdown reflects the opportunity cost if you will, in terms of contribution of the refineries. The Asset Utilization is a general category, which includes initiatives having to do with how we run the refineries.   Examples of this performance would be energy saving, different crude slate, utilization of more grades of crude, depending on what the LP suggests, and what the market conditions are, and of course, improvement of the yield of the unit; so better running of our existing refineries.

Given that we are at the start-up of the run in terms of the shutdown, this makes it even more pronounced. On the supply side, it has to do with how we purchase crude, and this is a combination of a number of factors. One of them is our ability during 2015 to switch purchases from open credit, to the beginning of the year and 2014, to prepayment or LC-backed purchases. Clearly, that allows us to take advantage of a lower price, given that we eliminate the credit premium in the purchase, plus the ability to have more optionality in terms of where we buy crude from. So again, this is…if you will, the Company is doing in delivering this performance.

Moving on to Page 11; I think this is just repeating our views, which is the cyclicality of the business, and its relation to the benchmark refinery margins. So I will not stand for too long on this page.

And I will move on to Page 12, where we show the operating cash flow, which is defined as EBITDA less capital expenditure, and a comparison of 2014 net debt to 2015. The strong cash flow allows us to effectively cover all operating needs and build enough cash reserves to be able to service our obligations which come due in the next 5 to 6 months.

Page 13, a brief overview of our capital expenditure program, clearly, in the last few years we have been investing significantly in the upkeep of the refineries. Since 2013, we have reverted back to a normal maintenance CAPEX. I would say that about 70% of this capital expenditure, what we call stay in business CAPEX and about 20% to 30% depending on the year, we will have to do with a bit of a growth capital expenditure either in the form of de-bottlenecking in one of our refineries. Adding some logistics assets or expending the network of petrol stations in Greece and International expansion, might mean the number of locations or the model that we use i.e. converting from a CODO to a COMO model of a petrol station.

Page 14, we briefly described the framework agreement with NIOC, and effectively what we have achieved is to be able to recommence purchasing of Iranian crude, which is suited for our refineries. Negotiate and agree on a reasonable settlement for the amounts that were due to NIOC. And of course, we expect that over the next few weeks, subject to a number of regulatory issues and logistics issues arrangements, we should be able to start implementing this agreement.

Moving onto Page 15, our Funding structure; we haven't changed a lot since the last time we spoke. I think, the only material…new piece of information that we can add, is the fact that, as we come up to the May 2016 maturity of the $400 million bond, we are pleased to confirm that we expect to be repaying that bond in full through our own cash reserves. And we are preparing…should conditions allow it over the next few months and maybe towards the end of the second quarter or later even, to reopen the market for Greek issuers. But this time we will be effectively going for a true refinancing and re-profiling, rather than raising capacity to allow us to continue our business operation or to invest into something new. So I can assure you this is a much more pleasant situation to find oneself in, to find somebody else…to tackle this issue, rather than to have to raise capacity to complete an investment.

Now, unfortunately dividend is not going to be proposed during this year's AGM. There are two main reasons for that; the first one is the relatively material write-down of inventory which has eroded our distributable reserves base on the tax basis, not on an IFRS basis, which means that there is a little bit of tax funding and restructuring that needs to take place there, as well as, the relatively high cash outflow schedules that we have for the first part of the year. We hope and expect that during the last part of the year, we will be able to revisit this issue. That concludes the discussion on the Group.

And I move onto Page 18; now, for a brief discussion of details on this specific business units, starting with the refining, supply and trading business unit. As I said, doubling of the adjusted EBITDA is a very strong indicator for the performance of the business.

And you can see on Page 19, the evolution of our sales. We have always effectively tried to utilize our refineries as much as possible…sorry, the evolution of our production. And you can see here that with the exception of the second quarter 2015, where we had the turnaround of the Aspropyrgos refinery, we have been able to maintain a relatively consistent high throughput and high utilization of the refineries.

The fourth quarter was the highest quarter ever in terms of throughput. We have been able to run all of our refineries at a very high utilization rate and with a very good yield because it's not enough to just feed barrel through your refinery, you have to get the right products as well. So you can see at the bottom of the page, two aspects; the first one which supports the economic performance, the first one is the increase of relatively heavier crudes or more sour crudes in the slate. So you can see that the Iraqi crude is about 31% compared to 19% last year, and they have taken effectively part of the lighter crudes CPC and other types of crudes which have been determined on the basis of LP. And of course, we have been able to maintain a very high percentage of high value products, which is almost 80% of our total production, even with the heavier crudes.

Now, highest through put and higher utilization means, more volume and more products available for sale. Given that our domestic market has not grown by that much, a lot of the additional production has been exported with over 50% of our annual production being sold to international markets, part of it going to our own subsidiaries and part going to third parties.

Now, on Page 21, we have tracked the benchmark margins and the net realized margin by quarter. Now, clearly, we are not delivering twice as much as the benchmark margin, because of the way we run the refineries. However, this includes trading premia as well.

What is important to note, is that, over the last few years…over the last few quarters, and especially during the last two to three quarters, we have been able to improve the over performers of the refineries. It’s not a lot, I mean, we are not getting $2 or $3 of additional contribution, but even getting $0.50 a barrel out of the existing refinery is probably a very good indicator of how well we do. And I remind you that the 100 million barrels per year, that means $50 million of additional contribution without investing a single cent.

So over performance and the ability to run the refineries at a decent rate and yield is a key driver to our results. Petrochemicals benefitted again from a very strong margin environment. And we treat the Aspropyrgos splitter contribution as a petrochemical profitability, which is shown on Page 22.

And moving onto Page 24, we see the marketing business of our Group, which is if you will outside the gate of the refinery. Now, domestic marketing has regained a lot of its profitability of previous years. You can see that just at the beginning of the crisis in 2010, we were reporting about $43 million of adjusted EBITDA. In 2015, we are pleased to say that, we are back at that level of $47 million, which has not been an easy task.

I think over the last few years a lot of the effort at the highest level of the Group has gone behind, if I may, use the word fixing the business model of retail, and making sure that we right size the business, which is now serving half of the market that it uses to do few years ago. So this is a lower number in terms of contribution, I mean, compared to refining, supply and trading, the number might seem low. But, I can assure you that getting these numbers is probably as hard as the refining performance in itself.

International marketing, we have a record year close to $60 million of full year adjusted EBITDA, that’s down to strong performance from all the markets, and increased integration with our own refineries. So we are pleased to be able to report that.

Moving onto the power and gas investments; Elpedison has suffered especially in the first part of the year from two negative factors. The first one was, the lack of capacity certificate framework which is still the case, as well as, a very disadvantaged supply costs, given that crude oil prices and gas prices were relatively high.

This has changed in the fourth quarter of 2015, and you can see it in the performance. So effectively, we expect that as we move through 2016 at a lower crude oil price and gas price environment we should see more utilization of our assets, and we expect that soon, the new framework will be in place, which will allow us to be able to recover some of the capacity and flexibility remuneration that we are entitled to.

Now, the issues with the Elpedison business and the IT piece in general have had an implication on DEPA as well, where volumes have come down. You can see that in 2015, the fourth quarter is actually 39% up compared to last year, whereas the full year is a mere 2% up given the very low sales to IPPs in the first half of the year.

Now, with respect to DEPA, I think that the main issue which is outstanding is the progress on the DESFA privatization. We continue to treat DESFA as part of the DEPA Group as an associate, and we will do so until the transaction is not subject to any regulatory clearance processes.

The SPA has been extended to September 2016, and we expect that between now and then the issues which affect this transaction will be further analyzed and resolved.

Now, that brings us to the end of the discussion. As usual, I will not go through the financial appendices. And we are happy to take any questions you might have. Thank you.

Q&A

OPERATOR: The first 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 few questions from me; the first two questions on Iran. Can you provide a bit more detail on the kind of timeline for the repayments to the Iranian National Oil Company? And secondly, do you have a rough idea of the financial benefits from being able to import Iranian Oil again, and perhaps more generally, what do you expect in terms of benefits on crude differential for this year? And my third question would be on, just the refining environment, what you are seeing so far this year in terms of margins and what do you expect for the rest of the year? Thank you.

STERGIOULIS G: Okay. Regarding Iran, I'm sorry to say that it's been a confidentiality agreement between NIOC and Hellenic Petroleum. And therefore details of the agreement are not to be announced elsewhere. What I can tell you is that this agreement was a good surprise for us. It was very well documented and prepared from our team. And we expect to be within our cash flow capabilities.

Now regarding the financial benefits of the crude oil resupplying to Hellenic Petroleum, I have to tell you that both of our refineries are complex refineries in themselves, Aspropyrgos and Elefsis, have used as a design basis Iranian light and Iranian heavy crude oil slate, meaning that we do expect an over performance based on that. But in any case, we are in a position to get Iranian crude oil based on our…on a benefit base. I don't know Ioannis if you want to add any points to that.

PSYCHOGIOS I: The only figure I would like to add is that we will choose the Iranian crudes in different grades of this, according to our calculation and using our Helpe's terminals that we have, and we will have to choose always the best crude from the available one. So Iranian again is an available type of crude, and we will try to get as much margin as possible from this. Of course, it depends also on the pricing that the Iranians will have every month for the next months. And we will evaluate every month and every quarter how much of this crude and which type of the Iranian crudes we will use.

STERGIOULIS G: Now, regarding the margins. You tell us and we will be rich. I wish we knew where the margin will go about, and what we can say is that our basis of refineries is that one of our two refineries is gasoline based, the other is diesel oriented, meaning that as an average we can capture both the summer and the winter season. But regarding the level of the margins, all I can tell you what happened in January, it was a good month, surprisingly enough the gasoline margins were good enough. But, I can make no prediction, and I'm afraid nobody can. We do expect a positive margin. We do expect a positive system margin, because as you very well know, all our refineries are fully integrated, but this remains to be proven. Thank you.

PATRICOT H: Okay. Thank you very much.

OPERATOR: The next question comes from the line of Mr. Lofting Matt from Nomura. Please go ahead.

LOFTING M: Yes, thanks. Good afternoon gentlemen. Can I just ask another question on the agreement with the Iranians? I appreciate there is some confidentiality in terms of specific numbers. But, I mean, I imagine directionally you must be paying a premium to market rates on those crude purchases as they start in order to work off the existing payable that sits on the balance sheet. Could you just confirm that is the case and if you can give any indication on the extent of the premium spread you are paying? And secondly, I was just wondering, if there is any…is there any risk scenario post putting that agreement in place, whereby the Iranians could still demand an accelerated payback on that payable, for example, if sanctions were to be put back on by the EU? Thank you.

STERGIOULIS G: Andreas?

SHIAMISHIS A: Hello, Matt. First of all, the agreement has two legs, the first one has to be the recommencement of our supply of Iranian crude and that will be done at market rates. There is no premium or discount other than what is normal when you buy from an OSP based seller. So that is completely, if you like, separate from any repayment schedule. Now, on the repayment schedule, if you will, we have two parts to what we owe them. And I'm not going to give you numbers like we have been giving you numbers for the last four years. But…and especially with the confidentiality agreement that we have in place, it's even more difficult.

Now, a part of the payable relates to normal trading credit that gradually as we start buying from Iran it will effectively replace old payables. And a part of it has to do with the additional frozen funds that we were not able to remit. Now, the agreement with NIOC includes, as I said they are reasonable and are not at liberty to disclose years and payment profile. A reasonable settlement of that old payable and the gradual replacement with new crude oil supply payables. We do not see any risk irrespective of the overall environment.

The relationship with NIOC goes back for 30 years. And as we have always maintained, it is a relationship that will continue to be with us, subject to the international environment. And in that spirit, we have been able to work out a good compromise. Now you may have seen that there are press reports which involve some sale of products to the extent that this is economical, it is something that we will explore. But I can confirm that there is no risk on this agreement, which might be driven from any future changes in the environment.

LOFTING M: Okay, great. Many thanks.

OPERATOR: We have a follow-up question from the line of Mr. Patricot Henry of UBS. Please go ahead… Mr. Henry, your line is open, but there is no sound coming from it.

PATRICOT H: Sorry, I was on mute, apologies. A couple of follow-ups from me; the first one on the working capital, obviously I have seen another large movement this quarter, is it a more normal level, you would say? And then secondly on the dividend and a possible return in the second half of 2016. Is there a specific metric that you have in mind in terms of net debt to EBITDA, at the gearing level which would make you more comfortable or is it more related to the DESFA disposal, what's the thinking on that? Thank you.

SHIAMISHIS A: Hello, Henry. Now, in terms of working capital, I think we have seen an increase in the second…in the last quarter compared to the third quarter. There are a number of reasons behind that. Third quarter, if you recall, we had just gone through the capital controls and the bank holiday, and effectively, in order for our refineries to get crude, we actually had to prepay upon placing the order and before the ship left its loading port. So there is a good swing between then and the end of the year, we have…where we have open credit and if anything we have pushed for extended credit at the end of the year. And it's not a small number. So if you sort of take into account that we buy about $400 million a month on average, clearly that is something which is affected by crude oil prices. If you prepay for a month, that's $400 million lower working capital. If you get a month's credit thats $400 million the other way, so the swing between the two can be as much as $800 million. So that's a big driver for that swing.

The second reason is contago trades that we were able to put again in place at the end of the year. We had about three to four cargos, if I recall Ioannis…

PSYCHOGIOS I:: Four.

SHIAMISHIS A: Four cargos, so that's almost a couple of $100 million which again I would not call them normal to be honest. I mean, clearly if there is…if we continue to have contago in the market, we will try and put more cargos in place. But this is, if you will, additional volume and payables that we had. So I would probably shave off anything between €200 million and €300 million from the working capital before I would call it normal.

On dividends, now our net debt to equity has been grossly distorted by the recent drop in crude oil prices. We shaved off about €800 million worth of net equity over the last year, which is quite a lot. Given that we have passed our investment phase, and we are generating very healthy cash flows even at more mid cycle margins, our cash flows are positive to the tune of €150 to €250 million a year. It means that we can probably target to have a net debt to equity ratio of about 50:50.

Now, that is to be further refined, once we get through the first half of 2016, and we feel a little bit more comfortable about the repayment of our dollar bond, as well as, have a little bit more visibility on the DESFA transaction. I also want to remind you that €700 million sitting on the balance sheet do not generate any real cash flow which is an investment in DEPA, DESFA and Elpedison. So I guess, I would probably refrain from commenting on what the target capital structure will look like at the end of 2016 and onwards, and the dividend payout until probably Q2 is out of the way.

PATRICOT H: Understood. Thank you.

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

STERGIOULIS G: Okay. Gentlemen and ladies, thank you so much for this very interesting debate. It has been a year with controversial feelings, at the same time, a challenge to break this year's record. It seems that the Company is capable to do so. We cannot influence the crude oil prices, we cannot influence the margins or the exchange rate, but we can run our refineries safely at full capacity, optimize our crude oil slate, exploit new markets, and get our shareholders proud of being selected to invest in this Company. Thank you so much.