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"Second Quarter and First Half 2021 Financial Results" Conference Call

Thursday 26th August 2021

18:00 (GR Time)

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Conference Call Conducted by Chorus Call Hellas

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OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Maria your Chorus Call operator.

Welcome and thank you for joining the Hellenic Petroleum conference call and Live Webcast to present and discuss the Second Quarter & First Half 2021 Financial Results.

At this time, I would like to turn the conference over to Mr. Andreas Shiamishis, CEO, Mr. Christian Thomas, CFO, & Mr. Vasilis Tsaitas, Head of Investor Relations.

Gentlemen, you may now proceed.

SHIAMISHIS A: Thank you very much for the introduction. Good afternoon for all of you, who are at the other end of the line. Thank you for taking the time to sit through the Presentation of our Q2 Results. Effectively, what we have is an improved environment in the second quarter, compared to the first one this year, and of course, compared to 2020 second quarter, which was probably one of the worst periods for every industry in the world. So, this improvement in the environment has helped us to deliver better results, both against last year and the previous quarter, which if we take a closer look, we will see that there is still some sort of discrepancy between the drivers, so we've effectively a continuously weak, a continuous weak refining environment.

Our performance improvement has come mainly from the petrochemicals business, where the international supply constraints on polypropylene have helped margins, and our results to a record-breaking level, and our commercial business, our marketing activities which we have seen an improvement, both in terms of market shares and in terms of profitability.

So, in summary, we have an environment which we've seen over the last few months, has recovered in terms of crude prices, and is pretty much at the pre-crisis levels. The weak margins, despite having a good performance from gasoline cracks, the weak middle distillate performance has not allowed a significant improvement in refining margins.

Having said that, this is reversed in the following months in July and August, where we see a significant improvement in refining margins. And of course, what everybody has been talking about, which is the cost of CO_2 emissions, which is double compared to last year, and just for reference over the last 4 - 5 years, it has gone up by 10 times as cost per ton. As I said, the market recovery is evident. The lifting of transportation restrictions is helping our auto fuel demand, but the aviation travel, at least until the end of June, has remained very weak.

In terms of our performance, of our results, as I mentioned, we have an improvement on pretty much all fronts. Our adjusted EBITDA, just under €80 million for the quarter. The refinery performance has been kept back not only because of the environment, but also because we've had to reduce the throughput at the flexicoker, at the Elefsina refinery and in fact stop for some maintenance work, as a result of the incident with the power grid failure back in February.

That has caused a number of mechanical issues, which we are identifying and repairing as we go along. Given that it was a weak margin period, we decided to curtail the throughput of our flexicoker unit, so that we could take the time and fix what was wrong during the power grid failure.

In terms of reported results, we have an even better performance. The continuous increase of crude oil prices has led to additional inventory gains in the quarter. However, this is not just it. As part of our presentation every quarter, we have a policy of providing for the deficit in CO_2 emissions. So, we take our annual allowances, we spread them throughout the year and then depending on how much real emissions we have, actual emissions we have, we provide for the deficit. And that is something which is very useful, because it helps us to understand and track the performance on a monthly and quarterly basis.

However, the application of IFRS in a specific area, requires that we exhaust all allowances from the beginning of the year and then take the hit as a one-off at the end of the year, which is what we have done in the reported results, which meant that we had to record a positive impact of around €70 million. However, this is expected to be reversed at the end of the year, given that the shortfall in allowances will have to be bought and paid for. However, for comparison purposes and for adjusted results, we accrue on a quarterly basis our CO_2 deficits.

On ELPEDISON and DEPA we have improved performance both markets, the power generation and the natural gas have performed better. Of course, the power generation performance is hurting us at the refining side we have increased energy costs. However, this is something which is structural and there's not much we can do about it.

On the financing basis, our liquidity and capacity are adequate, we have no issue there. We have a refinancing process, which evolves around retiring, repaying effectively some of the bonds that mature in the next couple of months, and investigating the refinancing and the possibilities of going to a new debt capital markets transaction on the basis of the new group structure, which is in progress.

On strategic initiatives, I think we have been quite successful and covered a lot of ground over the last few months. We've managed to get a new Articles of Association approved by the shareholders. For the first time in its history, the company has a board which is in its majority elected by the AGM.

We have adopted the corporate governance code, which is something quite material given that that's the framework, that's the pillar of how we run the company and the group from a governance point of view. And in July, we applied all the necessary changes to the governance framework. So that we comply with the new Greek governance law.

As an additional step, part of Vision 2025, we decided and preliminary approved at board level the new structure, which was presented at the AGM, whereby we effectively hive-down, we spin-off the refining and the petrochemical activities in a new subsidiary and we keep the holding company as the listed entity. This is something which is useful for the implementation of the strategy, and it will allow us to have a cleaner structure and a differentiated route to market for the different activities.

In terms of business development, the Kozani renewables project is almost half in terms of completion, and it's on track to be completed by the year-end. So come… Quarter 1 of 2022, we expect to see the first operating revenues in a material way coming from renewables.

On DEPA infrastructure, we have completed the offers process. We expect that we have received 2 binding offers. We expect that in the next few weeks this process will be completed, and we will be able together with the Hellenic Republic Asset Development Fund, TAIPED, to announce the successful bidder.

Finally, you know, we have a number of subsidiaries outside of Greece, one of the strategic initiatives that we took was to try and sort out various longer standing issues in these subsidiaries. In the case of Cyprus, we had the relocation of the fuel's terminal and the relocation of the LPG terminal. While we completed the fuels terminal relocation through a new terminal that we built, we decided to form a joint venture with the other LPG trading companies in Cyprus with the obvious benefits on CAPEX and operating cost synergies. So again, that's something which will effectively save us about €20 million of CAPEX that we would have to spend had this not been agreed.

In terms of numbers, on Page 4, as you can see, we have an overall improvement on all fronts, the operating performance is better than last year, well, I would say not difficult given that last year was one of the worst quarters ever in refining history.

However, it is important to note that the improvement comes from mainly the other sectors and not the refining. So come July, August, with the increase in refining margins and the increase in sales, we expect our performance and profitability to revert to what I would say more mid-cycle levels.

Now, with that, I will turn over to the industry environment. And I would ask Christian to walk us through the next couple of sections.

THOMAS CH: Thank you, Andreas. Good afternoon from me as well. On Page 6, you can see the crude oil prices recovering to pre-crisis levels basically, and they're standing at the highest of the last 2 years on sustained supply deficit, standing at $69 for the average of the quarter. The dollar is still weak against the euro, which is not helping our results. And this is basically due to monetary policy and other macro developments.

Now on the crude differentials, the Brent-WTI was slightly narrower whilst we had a slight further widening of the Brent-Urals spread, compared to what we saw in 2020, where we had the inversion of the curve.

On the next Page 7, just to discuss a bit the benchmarking margins. The gasoline cracks started recovering because of the transportation improvement. Diesel still flat. Naphtha and fuel oil falling back a bit. Of course, the weak air travel situation did not help that particularly. These cracks gave us the margins, which you can see on the right-hand side where you can see for the FCC 2.3 and for Hydrocracking 0.1.

Now moving on to the next page. As Andreas mentioned before, you can see what's happening with the EUA prices from 2017 to today and the tenfold rise. So, there is basically a significant penalization right now going on, whilst at the same time we've got lower allowances as well, as you can see on the right.

Now, with the domestic market environment on Page 9. Obviously, you know, the increased traffic helped transport fuel's demand go up. However, you can see the series for the first quarter and the second quarter for the 3 years in comparison, of course, 2020 being a difficult year for 2Q as well as we entered the corona virus period. On the bottom of the page, you can see the recovery basically of motor oil gas, diesel, as well, and the normalization of the heating gas oil, following the spike last year due to the special regime.

On Page 10, you can see again also bunkers demand recovering, which is good. However, aviation is still under significant pressure, as you can see 72% against 2Q '19, for example, which was a normal environment.

Now moving on to Page 12, as always, we show you the causal track and the segmental analysis. How we go from…this is 2Q '21 versus 2Q '20. How we go from €63 million to €79 million. As mentioned before, we were supported by the slight improvement in margins, not very supported by the FX, the EUA pricing as well gave us some headwind, however, the, you know, market recovery for fuels both locally and internationally, together with the good margin on the polypropylene helped us in terms of the environment support the results.

Now on the performance, as Andreas mentioned before, we had the unplanned shut down for the refinery, which didn't help our results. However, due to good trading and our own operations, we managed to exceed that, so taking us up to €79 million for the quarter.

Moving quickly on to Page 13, we are in the process of having a look, especially with Vision 2025 at our capital and funding structure going forward. The gross debt sourcing stands more or less where it was last quarter. Well-spaced-out maturities, you can see the gray bars, the bonds maturing. The 2024 bond trading at 2.06, whilst the financing costs at approximately or rather lower than €100 million per annum now, especially after the…all the moves we've done over the last couple of years.

Now on that, I'm going to pass over to Vasilis Tsaitas, who's going to give you an overview of the business units.

TSAITAS V: Thank you, Christian. Good afternoon to all of you attending our call today. We will now discuss the business performance of our main units starting from refining supply and trading on Page 16. So, we had an improvement in the benchmark margins as it was mentioned before. The very good trading performance was enough to largely offset the negative impact from the unscheduled shutdown of the Elefsina flexicoker, and we were able to maintain this improvement on our realized margin.

However, moving from the dollar realized margin to our euro EBITDA, we've had the impact of propylene contribution, which is reported under petchems, while it is included in the benchmark. So, this is the way that, that we show our results, as well as the higher operating costs coming from the CO_2 prices, as well as the electricity cost, which is again largely CO_2 driven. And these 2, I mean the CO_2 and electricity prices, are structural changes that will affect also the coming quarters.

Moving on to Page 17, effectively the operation mode of Aspropyrgos, and the slowdown at the Elefsina flexicoker are driving production levels, the crude slate, which is heavier due to the Aspropyrgos operation, as well as the yield of our products.

Moving to Page 18, the… despite the… there was a small recovery as we mentioned before in our domestic and duty-free sales, however, there's a significant increase in our exports to a record high 2.7 million tons representing two-thirds of our total sales.

Moving on, on Page 19. As we mentioned before, we were able to sustain a strong over-performance and realized margin. Despite the significant variation in the crude spreads; last year in second quarter, due to the turmoil in the market, and the excess supply with the collapse in demand, we were able to take advantage of the wide spreads, it was the other way around in the second quarter, with the situation normalizing in the third quarter. And let me remind you again that a significant part of the contribution here is reported under petrochemicals.

On that note, moving to Page 21, we have another record result from petrochemicals. The global polypropylene industry faced a supply deficit throughout most of the first half. So, we're able to have almost full availability of our plants, both at Aspropyrgos splitter unit, and the polypropylene complex at Thessaloniki and take advantage of these good international environment conditions. Balances have been normalized in the third quarter. However, margins are still at good levels, but not obviously at the exceptional that we've seen in the second quarter.

Moving on, on Page 23, our domestic market was…our domestic marketing business took advantage of the transport fuels recovery both in diesel and gasoline versus the second quarter. On top of that, we also were able to introduce, successfully introduce mid-grade premium fuels in our network with very good penetration and market share gains. As a result, we've had the material improvement in our performance. Still lagging 2019 numbers, obviously, and this is largely due to aviation traffic not having recovered to what we would call normal levels.

Same goes for international marketing; retail sales have increased in all our networks in Southeastern Europe. As a result of that, we have a significant improvement in our EBITDA of close to 50% versus last year.

Moving on to our new businesses on Page 26, we still have a target of 2 gigawatts of installed capacity. We're proceeding with the Kozani plant, as of the end of August, we're now at close to 65% mechanical completion rate. We are now scheduling to complete the mechanical works by the end of the year, targeting commercial operation in the first quarter of '22.

So, all in, we're looking at a portfolio of 1.3 gigawatts at various development stages, including our small operating, our construction portfolio, mainly Kozani and another half gigawatt in advanced permitting stages.

On top of that, we're looking to further expand our pipeline with another gigawatt more or less of permitting in early stages under evaluation. Other than wind and PV we are also looking at the storage projects with 125 megawatts already submitted in various group sites.

On Page 28, now moving to our gas and power associates starting from Elpedison, it's another quarter of very good performance taking advantage of the higher SMPs. The ability of the gas units to take advantage of the new operating model, and obviously the improved contribution of the Thessaloniki plant following the upgrade that we undertook in the fourth quarter making Thessaloniki, a very efficient plant.

Finally on Page 29, we have also good performance and contribution from DEPA commercial and infrastructure business. The main driver for DEPA commercial results is actually the relative attractiveness of piped gas versus LNG as prices in the latter have increased in the second quarter. So DEPA commercial was able to increase sales and consequently their EBITDA and net income contribution to our results.

So, on that note, we will stop here the main part of the presentation and turn to you for any questions you may have.

Q&A

OPERATOR: The first question comes from the line of Patricot Henri with UBS. Please go ahead.

PATRICOT H: Yes, good afternoon. Thank you for the presentation. Two questions, please. The first one, just want to come back on refining and comments you made around operations, and the coker some issues that you had. I was wondering if these issues are hopefully behind you or if that's still impacting the performance in the first quarter, because as you mentioned we are seeing better margins at the moment. We are wondering to what extent you are able to capture these better margins now?

And secondly, I wanted to ask about the latest demand trends that you are seeing in Greece after June if it's been closer to normal recently. Thank you.

SHIAMISHIS A: Thank you very much. Very relevant questions. On the flexicoker, first of all, as you may recall, in February, we had a power grid failure in Greece which caused an emergency shutdown of the refinery. It was done safely. No, issues were recorded in terms of environmental violations or safety issues. However, these incidences tend to affect equipment.

One of these issues that was created was the malfunctioning of the light-ends compressor of the flexicoker which effectively…of the gas compressor of the flexicoker which effectively meant that we have to run the flexicoker at reduced capacity. Now, the refinery is up for a full turnaround in the next 6 to 12 months, so we have the option of either maintaining a reduced operation which was problematic at the flexicoker or shut it down and repair it… repair the compressor and restart again.

Given the margin environment, we opted for the latter. The repairs have been successfully completed. The unit is up and running at 100% and it will continue to be operating properly until the next scheduled shutdown, which as I said might be anytime between 6 and 12 months from today, but that is a normal cycle. This means that we are in a position to capture all of the improved margins in July and August, which is positive to be honest.

In terms of demand, July and especially August, we have seen the months which are actually very similar if not higher in some respects to 2019. So, one would expect to see a significantly stronger third quarter in a couple of months' time.

PATRICOT H: Ok. Thank you.

OPERATOR: We have a follow up question from Patricot Henri with UBS. Please go ahead.

PATRICOT H: Yes, thank you. I have a quick follow-up. Just on the renewables because you highlighted that you have, I mean, a fairly large portfolio of projects at various stages. I was wondering if you can give us a sense of how quickly you can implement these projects, so in terms to get from the 200 megawatts you are using now and the 2 gigawatts by 2030.

TSAITAS V: Hi Henri, and many thanks for the question. Most of our…we are trying to have a balanced portfolio in various development stages. Those processes, especially for the early stage take time. So, most of those projects will be maturing towards the back-end of the decade. So, in order to get to our target of the 600 megawatts over next couple of years, we will have to supplement with acquisitions.

OPERATOR: We have a question from Lamb Jonathan with Wood & Co. Please go ahead.

LAMB J: Thanks very much for the presentation. Seeing the C02 costs were a big factor in this quarter and less likely to be so in the coming quarters, the renewables that you are building, the solar power investment that you are making is coming on by the end of this year, will that in some ways reduce your C02 liabilities?

SHIAMISHIS A: Jonathan it's effectively a virtual economic hedge, it doesn't neutralize the liabilities because as you know, we have CO_2 emissions which are scope one of our industrial operations, scope two, the energy provisions and scope three, the product. Now, I won't even dare to go on that front, on the scope three. Scope one and two, is something that we manage on the refinery basis. Now, whether you own the asset, the renewable or whether you procure the energy from renewables, you can still offset emissions under scope two.

So, in this case, it's not going to affect the actual emissions and the deficit that we have, what we will do is going to create an offset, if you will, in a different business unit and its going to create an economic hedge. So, when CO_2 emission costs goes up, the refining will suffer but then the price of green electricity and green certificate will also go up. So, effectively it's an economic hedge rather than a now bright netting of emissions.

LAMB J: Okay. Understood, thanks.

OPERATOR: Ladies and gentlemen, there are no further questions at this time. You may proceed with your closing statements. Thank you.

SHIAMISHIS A: Thank you very much for sitting through this presentation. As I mentioned at the beginning, the quarter is a positive one in terms of delivering improved performance versus last year and improved performance versus previous quarter. We are seeing the recovery kicking in, in a number of different markets, probably the single biggest issue that we have is aviation which suppresses jet and middle distillates.

In the second quarter, we have seen the recovery beginning, in the third quarter we have seen almost a full recovery in demand and margins, which makes us feel little bit more comfortable that the worst is behind us. Having said that, we need to be cautious about the ups and downs of the COVID mutations and changes to the virus that we are facing, we are not out of the woods yet, we need to be very careful, we need to protect our people in our operations, and I am sure that we have better days ahead of us.

On the strategic front, we are taking big… or making big steps forward. We have approved with the shareholders our strategy for changes across the board, and it's time for us to implement. So, I expect that the next quarter and in fact the next couple of years we will be seeing the recovery of our core business back to its normal levels, with the new environment that is going to be around i.e., increased energy and increased $C0_2$ allowances. But a healthy fuels business with decent returns, and at the same time we will witness the development and the birth if you will of substantial positions, in the second pillar which is going to be renewables, power and gas. So, in that respect, I am quite optimistic about the outlook of the next few quarters. Thank you very much.