Galp Energia's Funding Strategy Presentation

Introduction

Ladies and gentlemen welcome to Galp Energia's Funding Strategy Presentation. The conference call will be hosted by Mr. Manuel Ferreira de Oliveira. Mr. Ferreira you have the floor please.

Manuel Ferreira De Oliveira, Chief Executive Officer

Slide # 1

Very good morning to all of you. Let me thank you for coming to this audio meeting with such a short notice. With me is Claudio De Marco, our CFO and Tiago Villas-Boas our Investor Relations Officer. Let me start by saying to you that we have yesterday an exciting board meeting where the detailed analysis of the work that we promised was completed and discussed. The objective of this short meeting is to share with you the conclusions that we have reached. I want to emphasize that those have been reached through unanimously vote, so with agreement of active vote. In short what we concluded is that there were no reasons that could support a rights issue. We were well fundamented, it will be demonstrated in the forthcoming figures and we will maintain the direction of our strategy, with focus on E&P and on the completion of the ongoing projects in Refining & Marketing and Gas & Power. We have in the mean time achieved the liquidity level of about €1.7 billion, which leave us totally relax in terms of execution of our CapEx, as is in our business plan. And I would also emphasize the commitment of all the board to maintain a strong balance sheet, as we have referred many times.

Slide # 2

I am going now to slide number two, and summarize the decisions taken by our Board. The first one has to do with the first set of decisions and have to do with CapEx. We've looked at the small projects that we have in our CapEx. We cleaned them up, out of those that we considered were not first priority in the plan. So, we rescheduled or redefine some projects, basically in the Refining & Marketing division and the biodiesel project. That removes from our business plan a round number of €200 million. Additionally, we cancelled some possible acquisitions that we had included in our gas business, gas distribution business, thus removing another €100 million. The major chunk of contribution to the reduction of funds outflow was a decision taken to share the construction of our first combined cycle plant with a partner. We now actually started the negotiations with the interested parties in acquiring and participate with a 50% stake in the combined cycle project. Likewise we have in the wind project partners that have been already referred to the investors. We have 34% of the wind project. Both of these projects will be financed through project finance, non-recourse project finance and we will be again run through partnerships. The joint management of the projects plus the project finance structure will remove €600 million of our business plant. Additionally, we look at our fixed costs excluding personnel, which had been in the order of €300 million a year referring to 2008 numbers. We have already in place a plan to reduce 8% of fixed costs, which represents €25 million a year, totaling €125 million for the period, contributing in that manner also to reduce our cash outflow.

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Another decision taken which we, at the Board feel is the best for every shareholder in order to complete the needs of capital of the company, was to propose in due time to the shareholders' meeting, a reduction in our dividend policy. Our guideline, as you remember was near the $0.32 per share and then increasing according to the net profit of the company. We expect, versus the existing dividend policy, to retain in the company during the period €500 million as a signal of the reference shareholders and also from our other shareholders, thus supporting the investment plan. If you add all those numbers, you'll have slightly above €1.5 billion of reduction in cash outflow. Let me say that we feel comfortable. If we had stopped here, we have then what we promised, that means we have liquidity to achieve the projects, to do what we are supposed to do and we have measures that will strengthen the balance sheet to the level that we committed to. However, we decided also to prepare the company to additional flexibility if there are circumstances, basically determined by exogenous factors that could be a source of additional efficiency or the source of additional income. That way we decided to create a legal entity, a company to which we will transfer all the natural gas distribution business that operates regulated assets. That will be done; it will take a good couple of months because of the legalities associated with that. So what we have here is a company that operates the regulated infrastructure. And it is then, if necessary, a source of income if we decided to sell a minority stake on that company to infrastructure funds or to the market. Additionally, we looked at the legal structure of the E&P business, we benchmarked it against our peers and we clearly concluded that we needed to look at its organization, so that we can adapt it in an efficient manner and if necessary do some portfolio optimization in case those opportunities arise, and that's good for the company and do not compromise the E&P objectives of the company.

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In slide number four we have a summary, nothing different than what I have referred to you, with the different components of what I referred before. The CapEx reschedule of 200 million, cancellation of acquisitions, €100 million, project finance & partners in Gas & Power €600 million, dividend policy retains €500 million. But obviously the cost of all of that is that we have unrealized cash flow, which including the cost savings I referred to you before, represents a total of €200 million. The overall result is that in the period, we are reducing the cash outflow by €1.2 billion. The CapEx that will be cut will be focused on the first three years in the front-end of the business plan and where the pressure was. Fundamentally, the major contribution comes from the new financing scheme of the power projects, as well as from the proposal for change in the dividend policy. We believe, however, that maintaining a $0.20 per share dividend is a clear signal of commitment to the shareholders that expect a dividend from their investment. Although, as you all know, our focus at least for this forthcoming period is on increase the value of the share rather on the dividend that we will offer to the investors. In the forthcoming page you can see how we distribute the CapEx for the next four years, 2009-2013.

Slide # 5

In a consolidated manner we reduced the CapEx from €5.2 bln to €4.3 bln, maintaining the investment in E&P in order with all projects that we are pursuing, slightly reducing the investment in Refining and Marketing, as I referred to you and in a relevant manner reducing the investment in Gas and Power, fundamentally in power rather than gas.

Slide # 6

The cost of this, is in page six, it is a reduction in the average growth, as expected for the period in EBITDA. We will reduce that growth from 15% to 12%, it is the price to be paid for maintaining balance sheet with investment grade quality. You can see that, and it's an interesting exercise, that we feel proud off, this has practically no impact in the net profit of the company, basically due to the fact that we reduced the financial costs and also the relevant impact in EBITDA is a consequence of the fact that in precice all power business enters into the P&L account in the line of financial results and not at the Operational level in EBITDA due to how projects are structured. So that's the relevant operation.

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In short, to conclude before I open time for questions: we will be investing this year below €1 billion, between €800 million and €1 billion. Our liquidity today is €1.7 billion which in a way also as a cost that represents total piece of mind for the execution of the projects that we are committed to in this transformational phase of our company. We have taken decisions to support the balance sheet that avoid net cash outflow of €1.2 billion. With debt in our simulation, we have maintained a capital structure with an investment grade rating. But we are not satisfied with that. We created additional flexibility that could be a source of funds if and when necessary. Particularly referring to the natural gas regulated assets that could be monetized if needed. Additionally, as I refer to you, we will be looking at our E&P portfolio and be opened to portfolio optimization if those opportunities arise and are good for the company. Additionally, let me say that we maintain, as it was our overall objective, EBITDA increasing at double digit levels and expect to create with this proposal value to all the shareholders of this company. Thank you for your time and I am available to answer to any questions that you might want. Thank you.

Questions & Answers Session

Hootan Yazhari, Bank of America, Merrill Lynch

Good morning, Manuel. I had a question regarding the portfolio optimization that you mentioned around the E&P business. In particular, I wanted to see what sort of optimization moves you would entertain. Would that be focused on selling down Brazilian assets or would it be focused on Angolan assets? I just wanted to get some clarity on what you are looking at there. The second question I have is regarding the project financing on the CCGT and wind plant. Can you give us some more clarity on the term? What sort of interest rate and how much equity you are going to have to contribute into those projects? Thank you.

Manuel Ferreira De Oliveira

Thank you, Hootan. Let me do a clarification, what we decided is to create a legal structure that facilitate a set of optimizations, because we are a newcomer to the E&P business. We have a legal structure that is not easy for that purpose and that's what we will be doing. What I can say to you is that the Board considers our investments both the producing assets in Angola, and in Brazil, particularly in offshore Brazil, as strategic assets of the company. The purpose that we have today is to ensure that we, like any other company have a legal structure that facilitates the asset optimization. But we are not committed to do anything. Our focus was to solve our balance sheet issues with reduction in cash outflow and that's what we have decided. The other two components I referred to you are prudent steps, particularly if necessary in turbulent times. I want to emphasize that the assumptions behind our strategic plan that supported these decisions, and we have been tested with advisers, they have been considered robust. But in the turbulent times that we live, we never know what the future lays ahead. So these are two measures, contingency measures that will be subject to further discussions in the Board if any recommendation is made. As far as the second question, what we have is simply consulted certain investment banks and we have concluded that it will be very easy to project finance both the wind project equity and CCGT project equity. We'll have partners in both. We expect an equity required between 20% and 30% of the CapEx associated with the project. But we don't have yet the pricing of those. We know those that are in the market and we better not comment. We'll have a competitive bidding for that process.

Gianmarco Bonacina, Equita

Good morning. I have three questions. The first one is regarding the partner that you mentioned to share the combined cycle plant. So at which stage are you in the negotiation? I mean shall we expect some news flow in the next few weeks or is something maybe that will take several months? The second question is regarding the CapEx in the Refining and Marketing. If you can explain where you will capture the CapEx and what is your target in Nelson complexity after you will basically upgrade your refineries. And the third question is regarding the E&P. There was some announcement in the past weeks from Petrobras about new discoveries in Espírito Santo basin. I was wondering if in the second half of 2009 you will likely increase the drilling activity because you have also some land there, hopefully to find some new oil. Thank you.

Manuel Ferreira De Oliveira

Thank you Gianmarco for your questions. Let me share the combined cycle project. We have several parties interested. We are negotiating. That process is ongoing. So we better not refer to the stage of those negotiations, because to protect the negotiations themselves. We have no difficulty having a partner to take 50% of SPV that we will build and ran the combined cycle plant. We are not in hurry, it will take more, it will take months, not weeks. As far as refining and marketing, the reduction is not in the major projects, the major projects are the two conversion projects in Porto and Sines, as well as the energy efficiency projects. Those projects are untouchable. They have good returns. They are important for the modernization of refinery system and they are actually ongoing underground. So the reduction is in minor projects, in refining and marketing. And in the postponement of the 2nd generation biofuels plant we had in our business plan, the construction of Ecofining unit in Sines, which we are now postponing. We are actually waiting for clarification in the legislation of biofuels in Portugal and in Europe. So we actually reprogram that out of the business plant. So it is from minor investments, including the rescheduling, reprogramming of the biofuels unit that made up the €200 million that I refer to you. In E&P, the Espírito Santos basin is continuously surprising everybody. We will have a well to be drilled in the last Q of this year. And I have nothing to add about that, we are confident of the success of that well, but we have to wait for it. And that's basically the three questions you asked. Thank you, Gianmarco.

Oswald Clint, Bernstein

Good morning. Just two questions, please. One is could you just clarify or tell us if there are any chances to your underlying assumptions, commodity prices, refining margins, gas margins et cetera, underpinning this new funding strategy. And then secondly just if you could tell us what your gearing expectations are for 2009 and 2010 that would be very useful. Thank you.

Manuel Ferreira De Oliveira

Our underlying assumptions have not been changed. We have tested them against consensus, and ask to three financial advisors to test them. And we were not advised to change them. So, I refer just one to you, because we never actually communicate to market the detailed assumptions behind that business plan. But what we basically said is that our business plan assumes gradual increase in crude oil from $50 a barrel to $65 a barrel throughout that period. And assume declination in the benchmark refining margins from the second level of 2008, the second part of 2008 and then declining in a continuous manner, up to the end of the period. All the other assumptions are associate with market dimension, exchange rate and other. And they are basically equivalent to the consensus of the market. As far as the gearing, what we have committed is very simple: that our debt would be lower than our equity and debt would not be higher than 2.5 times EBITDA. And we do not communicated market specific numbers, because they are dependent on the realization of the CapEx. As far as the year ahead, we are in difficult momentsof the industry to forecast numbers. I would prefer not to give any guideline. The year has been and is difficult to every industry player. What we can tell you as far as CapEx project is that we'll be investing according to the updated of our CapEx. Some number below €1 billion in the range of €800 million to €1 billion that would be our CapEx. And that in a way defines the gearing of the Company.

Claudio De Marco, Chief Financial Officer

Most of all, it is important to highlight the comment of Manuel that our financial maneuver produced a very strong effect in the first two years 2009, 2010, as Manuel said strong reduction in the investment and it doesn't affect the cash flow generation in the first two years. And the other contribution came from, of course, the dividend reduction. And then it means that compared to the previous plan, we reduced our cash needs of about 50%.

Hamish Clegg, JP Morgan

Good morning, gents. I've just got a couple of quick questions for you this morning. I wanted to ask you about what contingency plans you have set in place in case of CapEx over runs in Brazil. And if you are not got monetization, potentially something that would help to that. How much do you value that gas business? And my second question, I just note from the exact wording in your press release that you talked about, the study of a legal structure. I wondered if you could maybe clarify what the sort of timing if you like, is to whether or not you have a legal structure in place this year for your E&P business. And also whether or not you'd consider will be able to spin that off as a separate entity sometime in 2010?

Manuel Ferreira De Oliveira

Okay. Thank you for the questions. As far as the CapEx over run, what we are working very hard is for CapEx under run. So with the present market conditions, everybody in the consortiums that operate with us in Santos basin, give us indications that it is under-run rather than overrun. What could happen in Santos basin is that the success of the project could accelerate the investment. That is the contingency, and would be again a good problem to have. So as you know, there is a successful, long duration test that is taking place, it is successful to-date, no issues to refer. There is a well being drilled in the BMS 11 at this moment, and there will be news to be released in relatively short period of time. No concerns about that whatsoever and we have the Iara project also being developed. So there is no overrun, but we could over-spend if the project is really successful as we expect. But as far as what is committed, what is approved, it is in our CapEx plan and we're able to follow that investment. As far as the monetization of gas, the regulated asset base of that business is €1.1 billion as you know from our previous reports. If necessary, we can place in infrastructure funds or through the market or whatever decision is taken, 30%- 40% of that, so rising capital to support the E&P business. That decision is not needed with the present stimulations that we have ahead of us. As far as the legal structure of the E&P business, what we have? We have certain investments that are actually owned by our subsidiary Petrogal, others by GALP E&P... we need to put together what we have, to be organized in legal terms like any other E&P business, because this business is growing very fast, you know it very well. And when we are growing, there are always opportunities to optimize and if those opportunities are there, if they create value we have to take that. So that's using the normal practices of the business. In this business, as you know, every company is constantly looking at optimization opportunities and in order be in that position, we need to have that legal structure. We are not considering whatsoever the rising equity by selling equity or any holding of E&P. That scenario had been excluded in the debate that we had with the Board.

Anish Kapadia, UBS

Hi, it's Anish Kapadia from UBS. Two questions please. I was wondering if you could give a bit more clarity on your CapEx structure per annum in the new plan, if you can give us guidance for 2010 and 2011, in particular for your CapEx. And then secondly, I was just wondering if you are now ruling out a rights issue in some time in the medium to long-term in favor of assets sales to provide liquidity.

Manuel Ferreira De Oliveira

Anish, thank you. Let me tell you one thing, as far as our CapEx we never released our CapEx per year. But I don't need to tell you that the CapEx was front loaded in our business plan and it was that which created the stress that originated the present work. Out of the business plan we have basically 45% to E&P, 45% to Refining and Marketing and 10% to others. In terms of the distribution throughout the period. We have it concentrated in 2009 and in 2010. As from 2011 onwards we have a standard CapEx that is supported by the cash flow of the company. So the critical years of the company were 2008, where we made the major investment in the acquisition in the distribution business in Spain. 2009 is the peak of investments in Angola with Tômbua-Lândana being commissioned by the end of this year and the development of the Tupi first module that happens in 2009/2010. So as from 2011, the investment is standard, well supported by the cash flows of the company. So that's as far as distribution of CapEx. As far as rejecting forever rights issue. We never say never to anything in life. But there is no discussion at this moment whatsoever about the need of rights issues or capital increase. So we concluded that the growth project of the company can be supported with its own cash flows with measures similar to the one that we have taken now. Let me compliment that we as management feel proud of the exercise done, because it shows that when we put the executives and pressure to be innovative, they bring in solutions. The shareholders are supporting us with €500 million through the proposed change in dividend policy. And I am referring to the reference shareholders. So, we believe that everybody has given a little bit, the restructuring of the company with savings, the rescheduling of projects, the refinancing engineering that we made in power and also the support of the shareholders through retained results. And all of that makes the project possible and attractive

Anish Kapadia, UBS

Sir, can I just ask if you did need to raise further cash at some point, you would prefer the route of monetization of the gas business or something in E&P rather than the rights issue?

Manuel Ferreira De Oliveira

What we said is very clear, is monetization of the regulated infrastructure of the gas, regulated infrastructure and asset optimization, which is different than assets sale. We can organize swaps of assets, we can do that, optimize the cash flow of the business. There are many options that can be looked at and do it in a manner that creates value to the shareholders.

Henry Morris, Goldman Sachs

Good morning gentlemen. Sorry one final question I had was on the E&P CapEx guidance you gave €1.9 billion, to 2013, I was wondering if that included any CapEx in Tupi beyond the pilot project, so any CapEx for further ramp up of that field?

Manuel Ferreira De Oliveira

It includes the investment for the first module, after the EWT that is taking place which then is the first module of Tupi and the start-up of the second module and another EWT in Iara and the start up of investment in the second production module in Iara, so that's what is included in our business plan.

Thank you very much to all of you for attending this call and we hope to speak with you next time on the presentation of Galp Energia's 2Q09 results.

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