

Galp Energia's Second Quarter and First Half 2010 Results

Introduction

Good afternoon, ladies and gentlemen. Please welcome to Galp Energia's Second Quarter and First Half 2010 Results conference call. I will now pass the floor to Mr. Tiago Villas-Boas, Head of Investor Relations division.

Tiago Villas-Boas, Head of Investor Relations

Hello. Good afternoon and welcome to Galp Energia's 2010 second quarter results conference call. Joining me today, as usual, is our CEO, Manuel Ferreira De Oliveira, and our CFO, Claudio De Marco. We'll start our presentation with the second quarter and first half results overview, followed by a short-term outlook and an update of the execution of our transformational projects. Let me just end by reminding you that we will be making forward-looking statements, so I'd like to draw your attention to the disclaimer at the end of our presentation.

And now, over to Manuel.

Manuel Ferreira De Oliveira, Chief Executive Officer

Slide # 3

Thank you Tiago and good afternoon or good morning to whoever is on the other side of the line joining this call. I will go through the second quarter results after which me and the management will be available for questions. I go straight to slide number three. Let me start on this slide to emphasize the main drivers of the second quarter results. The increase in crude prices on a yearly basis was the major contributor to E&P results' growth, which were also helped by the increase in crude production. Galp Energia's refining margin showed a significant recovery both year-on-year and quarter-on-quarter, increasing \$1.8/ bbl in the second quarter of 2010 when compared with the similar quarter of 2009. Natural gas supply margins increased on a yearly basis, confirming trends already discussed in previous presentations. The second quarter 2010 net profit more than doubled year-on-year to €109 million, supported by all business segments. In the first half of 2010, the net profit amounted to €174 million, an increase of 72% year-on-year.

Slide # 5

I'll move now to slide number five, where I want to refer that the ramp-up of Tômbua-Lândana and Tupi projects were the main contributors for the increase in the working interest production of our E&P division, which in the second quarter reached 19,800 barrels a day, up 48% year-on-year. Regarding the net entitlement production, it showed a Q-on-Q decrease of 14% to 10,900 barrels a day due to the terms of the Angolan PSA agreement, leading to the decrease of the production allocated to cost oil, as the price of crude oil increased and the major part of the capex invested in the Kuito and BBLT fields has already been recovered. We would like also to highlight that net

entitlement production of Tupi and Tômboa-Lândana projects reached 460,000 barrels in the second quarter, which is approximately 46% of the total net entitlement production in the quarter. With the increase in both net entitlement production and crude price, the EBITDA of the E&P division reached €44 million in the second quarter, up 51% year-on-year.

Slide # 6

Now I move to the refining and marketing business segment and I'm looking at slide number six. The refining and marketing segment showed a strong performance both in the first half of 2010 and in the second quarter of the year, being the latter the most representative of true performance, once as you should remember in the first quarter of 2009, we were affected by the negative impact of the incident at Sines refinery, both in terms of the refining margin and the crude processed. In the second quarter of 2010, Galp Energia's refining margin was approximately \$3.4/bbl, up \$1.8 barrel on a yearly basis. This resulted not only from an increase in refining margins in the international markets, but also from the increase in the spread between heavy and light crudes, leading to higher premium to the benchmark that are benefiting our refineries, which tend to use crude oils heavier than Brent. Looking at the first half of 2010, Galp Energia's refining margin was up \$1/bbl to \$3/bbl. I emphasize once again that our margin in the first quarter of 2009 was negatively impacted by the Sines refinery incident. Hence it is not quite a comparable period in terms of operating performance metrics. The market of oil products continued to show a decrease both in the second quarter of 2010 and in the first half of 2010 impacting the volumes sold to direct customers, which decreased 7.7% year-on-year in the Iberian market. Nevertheless I must highlight that notwithstanding the decrease in volumes in this market, the marketing division continued to be a resilient business in terms of earnings contribution, benefiting from the synergies that are being captured, following the acquisitions of ExxonMobil and Agip's Iberian businesses. In short, I would summarize that this division showed an EBITDA of €134 million in the second quarter driven by the increase in refining margins and by the materialization of synergies in Spain.

Slide # 7

I move now to slide number seven and refer to the gas and power business segment. In the first half of 2010, supply volumes reached nearly 2.3 bcm, up 4% year-on-year, from which 605 million cubic meters were sold to the industrial liberalized segment as we have been forecasting. This segment showed a significant growth of around 270 million cubic meters, which is relevant, even excluding the incremental consumption of our Sines cogeneration plant, which corresponds to approximately 60 million cubic meters in the quarter. The natural gas volumes benefited from the Spanish natural gas acquisition that we recently completed, which accounted only for 22 million cubic meters. We must here highlight that these volumes corresponded to the May-June period and that the impact of this acquisition will be more relevant in the fourth and first quarters of the year due to the high seasonality of the domestic consumption in Madrid. The EBITDA in the gas and power business reached €94 million in the second quarter of the year, up 76% year-on-year, a result of better natural gas supply margins both in the quarter and in the year and incremental profit coming from the Sines cogeneration performance. We must highlight that the EBITDA had a positive contribution of an one-off event in the quarter, which was related to services earnings, but that impact was offset, on an EBIT basis by provisions associated with the renegotiation of a natural gas contract.

And I now hand over to Claudio, which will follow me presenting to you the financial performance and a summary of the short-term outlook. To you the word, Claudio.

Claudio De Marco, Chief Financial Officer

Slide # 9

Thank you, Manuel and good afternoon to everyone. Let me start by outlining the positive contribution at the EBITDA level from all the business segments, both in the quarter and in the half year, with the R&M segment showing the best incremental performance in the second quarter driven by refining margin increase. The E&P business benefited from both higher oil price and volumes including the already small production of 1,600 barrels per day from the Tupi Extended Well Test. The Gas & Power business was positively affected by the increase in liberalized market margins. Below the EBIT line, the net profit was impacted by higher interest expenses and by a decrease in associates results. The increase of interest expenses is linked to a higher average debt, on the other hand, with an improvement in interest rates from 3.8% last year to 3.5% in the half of this year. The associates results were penalized by changing the consolidation criteria related to a subsidiary which was consolidated with equity method in 2009 and with the line by line method in 2010. The effective tax rate in the first half was 25%, in line with the first half 2009 and with our guidance for the full year 2010. All in all, the net profit in the second quarter 2010 reached €109 million, more than double that of the second quarter last year.

Slide # 10

Now let's move on to capex in slide 10. The spending reached €288 million in the second quarter 2010 or €479 million in the first half 2010, confirming that the transformational capex execution is on track. In the E&P business, the capex was mainly focused on development works in Tupi 's field in Brazil in order to accelerate all the activities to put in place the first pilot project, expected to be in production in the last quarter of the year. In R&M, the majority of the capex was allocated to the refining upgrade project that entered in a more advanced phase of realization with the main equipment already in place. In the Gas&Power division, the spending in the second quarter was mainly focused on the cogeneration plant in Porto's refinery, which will improve its energy efficiency, as well as it will contribute to the natural gas volumes increase with gas consumption of about 220 million cubic meters.

Slide # 11

Looking at the balance sheet on slide 11, it shows a significant increase of capital employed compared with the end of 2009, mainly due to the increase in fixed assets in line with an aggressive first half investment spending. We also can see an increase in working capital resulting mainly from higher trade receivables. However, on a quarterly basis the working capital level was quite stable. We also have to point out that from the €4.8 billion in fixed assets €1.4 billion, is still allocated to work-in-progress related to our transformational projects that we expect, part of them, will generate cash flow starting from the end of this year. Total net debt reached €2.5 billion at the end of June, an increase driven by the investments in the transformational projects and also by the dividend of €116 million paid in May.



Slide # 12

Now in slide 12, we would like to give you an update of our debt structure. Despite the negative environment, we continue to maintain a very active relationship with the financial institutions, by negotiating some important loans. As a result, we improved the medium term debt reimbursement profile reducing the debt repayments to €100 million in 2011, before the current transformational projects' cash flow ramp-up. The reimbursement profile is now concentrated from 2012 onwards, so we can match better the operating cash flow with the financing outflow. As we already said the net debt totalled €2.5 billion in June and our liquidity position was €1.3 billion, from which 65% already committed.

Slide # 14

I'll now give you a short-term outlook based on our current forecast of some key drivers that will influence short term results. In the E&P business, the working interest production is expected to be in line with that of the second quarter 2010. In R&M, the economic recovery is uncertain and as such we still have a cautious outlook in refining margins. Concerning the natural gas volumes for the 3Q10, we are expecting a slight increase. In terms of the financials, our current liquidity position of €1.3 billion at the end of June, will support comfortably our transformational projects execution.

And now Manuel will present to you the strategy execution update. Thank you very much for your attention.

Slide # 16

Manuel Ferreira De Oliveira

Thank you Claudio. Let me finish the presentation with two or three slides referring to the main projects that we are developing to change the face of our company. I will start with slide 16, which shows you a totally outdated picture of Cidade de Angra dos Reis which is already fully completed with the tops installed and inspected and which left Dalian yard to Singapore on the 27th of July and is now traveling to the Santos Basin in Brazil. This, as you clearly know, is a major milestone for Galp Energia, for our business partners in the consortium of BM-S-11 and I would say also for the world oil and gas industry. This FPSO will be in place before the beginning of October, showing how efficient our consortium is moving ahead in order to comply with its commitment of having this facility up and running during the fourth quarter of this year. What I want to say is also that we have already awarded the contract for the second FPSO to install in the Tupi field, in Tupi Nordeste and it was awarded to a consortium made by SBM and Queiroz Galvão Group which will be in place in the first half of 2013, showing once again an acceleration of the previously announced program.



Slide # 17

Now let me refer the drilling program that we have ahead of us, which is mostly focused on Tupi and Iracema areas, where we are planning to drill five appraisal wells until the end of the year in addition to the four wells already drilled or reentered this year. So, it's quite an active program in BM-S-11 with five rigs presently operating of which four under long-term contracts. These will be our focus area as the clock is ticking towards the start of the commercialization phase, which in turn led us to decide to postpone to next year the wells in BM-S-8 and BM-S-21. We'll have a well to drill in BM-S-24. Let us now move to other regions also important to Galp Energia. In Angola, we're preparing to drill three appraisal wells, of which two are in block 14 and another appraisal well will be in block 32. The appraisal well Lucapa-6 in block 14, we'll start drilling in the fourth quarter of this year, being this well extremely important to reduce the uncertainty and select the concept of field development and then the respective FEED. In block 32, the appraisal well Mostarda 3, in the Hub 1 field, will start to be drilled in the third quarter of this year to support a reliable development plan and respective optimization. In terms of the exploration activity, we also have the exploration well in Angola LNG II, the well known as Garoupa 2, which is currently being drilled. Another exploration well that is in our pipeline is the well in Block C in East Timor, the Bonaparte well, which should start to be drilled by the third quarter of this year.

Slide # 18

Now, some few statements for another two important projects that are going on. The upgrade project in Sines, of which you have a picture in front of you, is moving ahead according to plan, with the crucial equipment already delivered and installed. The project phase in Matosinhos is advanced to be completed in the first quarter of next year and the Sines project to be completed in the second quarter of next year. As I said, the project is on schedule, on cost, with around €600 million already invested out of a total of 1.4 billion that is expected to cost.

Slide # 19

Let me now move to a project that we do not refer frequently. We also are in the Matosinhos refinery building up a cogeneration facility which is totally similar to the one that is operating in Sines, and it was commissioned last year. The Sines project was a success story both in terms of environmental performance of the refinery, energy efficiency, technically and economically. It is offering us an excellent return on the capital employed. In the Matosinhos refinery, we are building a similar, if not totally equal new facility, which again as you see in the picture is being now erected to be completed in the first half of next year which will increment the profitability of that industrial site, contributing to earnings of at least €16 million for the power business with additional margin left to the natural gas business and in the refining margin due to increased energy efficiency. The cogeneration plants, the upgrading project, the development of Tômbua-Lândana and the success story of Tupi, Iracema and Iara are the key projects that will transform the company in the next year and the half.

Thank you for your attention, we are available for Q&A.



Questions & Answers Session

Bruno Silva, BPI

Good afternoon everyone. Thank you for taking my questions. I'll try to concentrate the doubts I have. Basically I want to focus on EBITDA for the rest of the year, and in this sense I will break down as follows in marketing, not refining. Can you give some more color on the evolution of marketing margins in the Iberian market. You also mentioned opex synergies, what was the impact during the first half and what is still missing, or the upside for full expected synergies? And if you can manage to get that during this year. On the gas business, also very good performance. I would like to understand a little bit further on the supply margins, and what are the drivers, what level are they, how can they evolve throughout the year? And as well in terms of the network business, what could be the smooth effect on EBITDA for the second half? You also mentioned the natural gas contracts, what else can we expect in terms of new provisions until these contracts are settled?

Thank you.

Manuel Ferreira De Oliveira

Thank you Bruno. So let me take the answers to your detailed questions. The first is the estimation of EBITDA for the end of the year in what refers the marketing margin contribution. We see a stable result from the marketing division. With certain tension, because as you know the market is declining, so we do not want to make definitive statements. We are basically acting from the cost point of view and taking the synergies, with the acquisitions we made, to the extreme. I would say that in the 1H10 we had approximately between €15 million and €20 million of synergies. We are being extremely ambitious in the cost structure of this division to ensure that we maintain results, to counteract the declining of the market. As far as the gas business, we see the supply margins slightly declining, because of the pressure of the spot market of LNG, that is, as we all know in the business, now cheaper than contract gas. However, we do not see that affecting in a relevant manner our business. As far as the network business, it is stable, is a simple return on the regulated asset base, which is extremely simple to calculate and I'm sure you have it in your model. We have been provisioning in our accounts for the outcome of the arbitration process in our LNG II contract from Nigeria. The arbitration process has been completed with the result that satisfied us, that we are happy with. And the provisions we've establish are totally sufficient to deal with the consequences of that contract. But we see no new provisions in the gas business for the forthcoming part of the year.

Hootan Yazhari, Bank of America Merrill Lynch

Good afternoon, gentlemen. A couple of questions please. First of all, you alluded to the fact that BM-S8 and BM-S-21 have been pushed back into next year. Can you give the reasoning behind that and whether you have now secured a date to get the rigs there? And do you feel comfortable that it will be in 2011 or will it be potentially impacted further? And then just another question on a similar theme. Obviously with Petrobras looking to develop the Franco barrels, there has been a lot of speculation that you're going to see a re-phasing of developments. Do you feel this is going to affect the timeline of your key projects or is a risk which will less affect you? Thank you.

Manuel Ferreira De Oliveira

Hootan, let me take the drilling of the rigs available in the question of postponing BM-S-8 and BM-S-21. That was effectively due to the availability of rigs. So, when the decision was taken, the consequences on the rig market of the Gulf of Mexico tragedy were not yet on the market. Today, at this moment as you are aware there are rigs, but the program is going on. So the focus is going on to block BM-S-11, the arrival of the new FPSO is being anticipated. So the drilling program has to be anticipated as well, in line with the anticipation of the arrival of the FPSO. We have presently block BM-S-8 working under a long term contract, 4 rigs plus 1 under the short term contract. The consortium is working hard with another 5 rigs in 2011 to 2012. I'm sure that we'll be probably doing more than these because of the availability of rigs in the market by now. You referred to the Franco barrels, interfering with the development of Tupi, Iracema, Iara complex. We have no signals of that. On the other hand, if in the discussions of the consortium, if there is a word that we use, is anticipation to the commitments we made to the market. As I've referred in my short presentation, the FPSO number 2 for block BM-S-11 has been anticipated from 2014 to 2013. We are now thinking about the next one and as soon as we got reliable data, we will share it to you. So, the word in the consortium is not delay, is anticipation. Thank you.

Michael Alford, Nomura

Good afternoon, I've got two questions please. Firstly, you have mentioned in the past the potential to sell down some of your stake in your regulated asset base in gas. I was just wondering maybe an update on that process, whether that's still the case. And then just secondly, on the exploration rigs theme, the East Timor work that you are doing in 2010, could you maybe give a bit of color as to sort of the impact. Is it a high impact well, you are prospecting for oil or gas and maybe a little bit of color on risks associated with that well? Thank you.

Manuel Ferreira De Oliveira

Thank you. In the regulated asset base project we have, we are preparing everything. We actually have already hired an investment bank that is working with us to organize the possible sale of up to 45% of the regulated assets. We have not taken the definitive decision. We have gone through all the legal processes of transferring licenses and other internal regulations that we have and processes to have the infrastructure company totally set up so that we can sell a part of it, as and when, we need it and we now have a clear roadmap for it. We'll press the button when we feel that it is necessary. But the project is going as presented to the shareholders in due time. As far as East Timor well, it is an oil target. We have some expectations but I prefer not to comment on it. Let's wait for it to be drilled later this year. Thank you.

Oswald Clint, Sanford Bernstein

Thank you very much. Maybe just focusing on Tupi for the fourth quarter. Are you still expecting Tupi producers to come on stream in the fourth quarter running at around the 20,000 barrels per day level? Has the delayed equity issuance from Petrobras from first half into September time period, had any impact on the development progress so far for the consortium? And maybe, if it is possible to indicate the opex per barrel for the Tupi production so far in 2010 please? Thank you.



Manuel Ferreira De Oliveira

It is a matter of fact, we will commission the new FPSO with two wells as referred to you. The 20,000 barrels a day is not the production capacity of the well. It will be necessarily choked for reservoir optimization. On the 20,000 barrels a day, it is a number that we are working for a good operation of the reservoir, as we see reservoir today. And when the FPSO will be in place, it will work with Tupi 1 and Tupi South. The wells are already drilled, waiting for the FPSO. Other wells will then be drilled next year to take it to five production wells and three injection wells. In the phase 1 of this pilot project, we're taking the production to 80 to 100,000 barrels a day. To your second question, the opex, we have the numbers that come from our EWT, that is going on, which make us very comfortable. I would simply say they are typically similar to deepwater production, no much different from the number that we have in Angola for example. Thank you, Oswald.

Filipe Rosa, BES

Hi, good afternoon everyone. I have a couple of questions. The first one relates to refining margins. The performance in the quarter was quite good, but given I was looking at your production mix and looking at also to your crude diet and it's hard to explain just with the spread heavy-light, the improvements that you had. So regarding refining margins, was there any abnormal event when comparing for instance with the previous quarter? And my second question regarding the cash cost, also in the refining area, what was the major driver for the reduction also quarter-on-quarter? And my last question, given the net debt that you reached by the end of the second quarter, what would be now your guidance for the end of the year, if could provide it, in terms of net debt?

Manuel Ferreira De Oliveira

So let me address the refining question. When you look at refining margin, we use the standard benchmark refining margin that we publish and is defined by, actually, refinery models that are designed by the International Energy Agency. It assumes that it processes brent and then has a certain yield of products. In our particular case, we process crudes that are heavier than brent and then in principle with higher sulfur. We have equipment that allows us to produce heavier and sourer crude oils. So, our real refining margin is affected, first by the yields, the operation quality of the plant during the period, second, by the location of the refinery and third, by the differential between heavy sour crudes and light sweet crudes. This quarter that differential has widened up to levels much below the standard levels that the market expects under normal conditions. The reason why the heavy crudes are expensive relative to light crudes is because of OPEC cuts. Because when OPEC cuts production, the production they cut is heavy crude, because it is the one that is worth less. Hence, the supply of light crude is higher. So we will see the widening of light and heavy crudes when OPEC increases their production. We see the fundamentals of refining margin still difficult. So we are not over enthusiastic in the short-term about refinery margins. We are simply expecting to do a second part of the year as similar as possible to the first one. As far as the expectation of our debt to the year-end, I'll let Claudio answer to that question.



Claudio De Marco

About the debt evolution, taking into consideration that cash flow from operations is similar to the first half and taking into consideration an aggressive investment program, with our level of investment for the full year reaching the level of €1.2 billion, €1.3 billion, we expect an increase in debt of about €300 million, €400 million relative to the level of June.

Manuel Ferreira De Oliveira

I would add that it is in line with our plan. Thank you.

Hootan Yazhari, Bank of America Merrill Lynch

I just want to take the opportunity to ask another question. You indicated you're looking to drill another well this year in Júpter in BM-S-24. Can you give an update on how that's progressing and what you hope that exploration well will show? Thank you.

Manuel Ferreira De Oliveira

Thank you for your second question. You know that BM-S-24 is extremely important for us. You also know that the appraisal program for BM-S-24 can last up to 2016. So we are drilling a well in another side of the reservoir in order to ensure that we have a better knowledge, particularly to understand better the relationship between the ratio oil and gas. We are confident that it has more oil than what we expected at the very beginning and also the distribution of CO2 along the reservoir. These are basically the objectives. It is an important well. It will be drilled later this year and completed, most probably, by next year. Thank you, Hootan.

And by the way, to all of you, on behalf of my colleagues and myself, thank you for your time and wish you a fantastic holidays for those that have the privilege of having them. Thank you.

