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SPM.MI - Q1 2014 Saipem SpA Earnings Conference Call

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PRESENTATION

Operator

Good day, and welcome to the Saipem first quarter 2014 results conference call. Today's conference is being recorded. At this time, I would like to turn the call over to your host today, Mr. Umberto Vergine, CEO. Please go ahead, sir.

Umberto Vergine - *Saipem SpA - CEO*

Thank you. Good afternoon, and welcome to the conference call to discuss the Saipem first quarter 2014 results. I'm here with Alberto Chiarini, Saipem's Chief Financial and Compliance Officer, and Salvatore Colli, our Investor Relations.

Today we are going to go over the main points relating to our first quarter financial results, give you an update on the current backlog of both new and legacy projects, as well as update you on the operations within the drilling and the E&C business unit. I will finish with our comments on the 2014 guidance and then we will be happy to take your questions.

Before we go into the details, I would like, with slide 4, to give you an overview of the first quarter. As you know, our management objective has been to take actions which will stabilize Saipem in order to put in place the foundations for a sustainable recovery and profitability. During the first quarter we have continued to make progress on the physical execution and commercial discussion of our legacy contract, as we work with the clients to achieve the best outcome on these projects.

In the past few months we have experienced headwinds on working capital, which has impacted the net debt in the first quarter. Saipem's management is focused on tackling the issue of payments. We got a strong order intake in the first quarter, boosted by the significant South Stream contract win and since the quarter end, I'm pleased to say that we have won further contracts in excess of EUR3 billion, all of them in line with our commercial strategy implemented since the beginning of 2013.

Of course the pace of our recovery is contingent on both this higher margin new business awards and on the progressive delivery of the low margin legacy contract. The details we will run through now will provide the ground on which we are maintaining our guidance for 2014.

Before looking at the results in detail on slide 6, I just wanted to remind you that the figures of Q1 2013 were representing the E&C business before the issuing of the second profit warning, and therefore they are not entirely comparable.

Moving on, revenues amounted in the first quarter of 2014 to almost EUR3 billion, with more than 50% of those revenues coming from E&C offshore, while onshore only accounted for approximately 30%. These results confirm that our revenue mix is moving towards the E&C offshore segment, the more profitable segment.

In drilling, the slight reduction in revenues compared to the first quarter of 2013 was mainly driven by Scarabeo 7 downtime for scheduled maintenance that required more works than originally expected, work that was not foreseeable until maintenance began.

EBIT stands at EUR132 million. This includes the ongoing negative contribution of EUR29 million from E&C onshore, driven by the execution of poor legacy contract, in line with the 2014 guidance. E&C offshore has started to benefit from the ramp up of new projects won in 2013. But this positive movement has unfortunately been offset by the negative impact of the extra cost associated with an operational accident in Brazil.

As you may know, in the middle of March the FDS vessel experienced a problem during activity on the P55 project in the Roncador field. The accident was caused by a structural failure of equipment and resulted in damage of a portion of the pipeline being installed. Remedial action plans was immediately implemented and we have reestablished safe operational condition, which led to the installation activity being resumed from 5th of April, 2014. As a result of this incident, we have booked additional cost of around EUR40 million in the Q1 results.

I would like to remind you that P55 was one of the entry ticket contracts won in Brazil a few years ago at low margin. The scope to absorb problems arising during the execution phase is limited and we see their immediate impact on the P&L as a result.

Turning to drillings contribution to EBIT, in the Q1 we recorded a lower contribution from Scarabeo 7, currently under maintenance as already explained, as well as the startup cost of the new onshore rigs in Saudi Arabia.

In conclusion, net profit stands at EUR61 million after financial expenses of approximately EUR40 million and taxes of around EUR30 million.

Turning to net debt, at the end of the quarter this stood at EUR5.56 billion, EUR800 million higher than at the end of the fourth quarter 2013, reflecting the impact of deterioration in working capital over the quarter. There are four major drivers of the increase in working capital over the first quarter.

The first two components relate to the timing and to the structure of the payments and milestones within the terms and condition of the contract. The first is the reversal impact of the down payments we received during 2013 from contracts won during the course of the year. Our Q4 cash position benefitted from these down payments. And during Q1 of this year we began the ramp up of those projects, incurring the cash outflows associated with those 2013 down payments. As you know, there was a lack of contract awards during H2, 2013, meaning that these outflows were not offset by new down payments during Q1. This accounts for about EUR110 million.

It has to be noted that the Q1 did not benefit of down payments of new contracts won in the period, such as South Stream and Jangkrik, that are expected to be cashed in Q2 and that amount to EUR170 million.

Secondly, EUR430 million deterioration derives from a combination of a fewer high-value milestone across a series of large legacy contract where bad payment terms are penalizing cash flow. The largest single component is the EUR170 million increase during Q1 in the outstanding position for Wasit in Saudi Arabia. These are the two components related to timing and structure of the payment and milestone of our contracts.

The remaining two factors reflect the intensive commercial dialogue with some of our clients as we reach peak execution and complete the late stage of the largest legacy contract. Following the improvements in payment achieved in the run up to year end, in Q1, there has been an increase in trade receivable of some EUR220 million due to delays in payments mainly in Nigeria, Saudi Arabia, China and Venezuela and Egypt.

Finally, as a fourth factor, coherently with the progress of the legacy contract there has been an increase in cost related to change order, still under negotiation, of around EUR90 million. These explain the increase in working capital over the first quarter, but there are a number of factors that give us confidence that working capital will unwind steadily over the course of this year, with the Company strictly focused on tackling the issues of payment.

In particular, these factors are the ongoing discussions that we are having with our clients to obtain change orders approval; the schedule of our legacy projects, with several coming to an end during the course of 2014; the turnaround of the penalizing cash flow profile of Wasit expected in Q3 2014; the ramp up of activities from new projects with favorable payment conditions; and finally, as we will discuss in the upcoming slides, there are a number of sizable commercial opportunities that could materialize in the coming weeks and months, down-payments for which will positively impact on our working capital. Just as an example, Kaombo will generate a down-payment in excess of EUR100 million.

For these reasons we are confident that the net debt guidance of EUR4.2 billion at year end is achievable, notwithstanding the headwinds seen in the first quarter.

Moving to the backlog and the new order intake on slide 8, we have had a good start to the year. During the first quarter we have reported a good order intake across all three E&C business units, amounting to approximately EUR4 billion. These results include some extremely important contract wins that we have already announced, in particular, South Stream and Jangkrik. On South Stream activity is progressing as per the plan agreed with clients.

At the end of March, the overall backlog stood at EUR18.5 billion, with more than 50% represented by E&C offshore. Some EUR600 million is related to amendments and change orders on existing legacy contracts.

As I have already mentioned, since the end of the quarter we have seen further contract wins in excess of EUR3 billion with associated down-payments expected in the coming months. We will go into some more detail on this new contract wins later on in the presentation.

Looking now on slide 9, at the backlog by year of execution. You can see from this chart that out of the total backlog of EUR18.5 billion, 44% will be booked in 2014, 35% in 2015, and 21% in 2016 and onwards. In terms of the projects to be executed in 2014 we've already reached a comfortable cover ratio ranging from 80% to 88%, and that gives us the confidence to maintain our revenue guidance for the full-year.

Furthermore, the good level of order intake year-to-date including the contracts won since the end of March helped to enhance visibility that we have on the performance of the business beyond 2014.

I now like to give you some of the operational details underlying the forward-looking factors that will drive 2014 performance and beyond, starting with the drilling business on slide 11. In offshore, in relation to our two mid-water rigs, in the first quarter we signed an agreement to extend Scarabeo 4 until the third quarter of 2015 at a flat day rate.

As per the Scarabeo 3, at the moment we are completing the activity on the current well, waiting for the final approval from the client for a 1 year extension until the first quarter of 2015 at the existing day rate.

Looking at the other segments of the fleet, we have a full utilization schedule for 2014. Beyond 2014, the top end deepwater units have contracts expiring not earlier than 2017, with the exception of Scarabeo 7 and Scarabeo 6 at the end of 2015, for which we are already in commercial discussions.

In terms of jack-ups, we have already started marketing activities for the four units whose contracts will expire at the end of this year and we are confident in the possibility to agree new contracts with improved terms.

In onshore drilling, the utilization rate in the quarter has remained very high, standing at 96%. As in the offshore division, we have already started marketing those rigs whose contracts are expiring during the year and we have received indications of similar or slightly better rates.

I now like to update you on some significant news on the E&C business. During the first quarter we have already -- we were awarded the long awaited contract for the construction of the first line of the South Stream for a total value of approximately EUR2 billion.

It is a particularly challenging job that only very few companies could carry out. South Stream involves a system of pipelines from Russia to Bulgaria across the Black Sea, each 930 kilometers long and to be laid reaching a water depth in excess of 2,200 meters.

Saipem will carry out the installation design and the construction for the entire first line, as well as the parts in shallow water, the shore crossings, the landfall and the associated facilities for the four pipelines that are ultimately part of the full project.

The pipeline construction will be carried out by the Saipem 7000, our state of the art J-Lay vessel suitable for ultra-deep water, which already constructed the Blue Stream pipeline in the Black Sea; and by Castoro Sei, the S-lay vessel suitable for both shallow and deep water, which previously laid several trunkline, including the North Stream Pipeline. The offshore deepwater activity for South Stream will commence towards the end of 2014.

Among the other major E&C award in the quarter, please refer to slide 13, it is worth mentioning the EPC for the Jangkrik floating production unit for Eni, offshore Indonesia, for a total value of approximately $500 million. The topside fabrication activities will be carried out in Saipem's Karimun Island Yard, located in Indonesia. This contract fits well with our strategy of growth in the area of floaters construction in regions such as Asia-Pacific and Africa, where we can exploit our well established local presence and our unique availability of fabrication yards.

Furthermore, in Canada, leveraging on our new yard in Edmonton, we have won three E&C onshore contracts amounting to approximately CAD500 million. Canadian Natural Resources awarded these contracts to Saipem for the development of the hydrotreater phase 3 of the Horizon oil sands project in the Athabasca region.

In addition, as we have mentioned, since the end of March we have won contracts worth more than EUR3 billion, out of which I will particularly like to highlight the contract for the construction, operation and maintenance of the two FPSO units for the Kaombo field, offshore Angola worth in total more than $4 billion. These new contracts confirm the strong commercial momentum we are seeing in the business.

In terms of full-year, we maintain the guidance we issued at the beginning of the year, which, as shown on slide 15, is as follows; revenue between EUR12.5 billion and EUR13.6 billion, EBIT between EUR600 million and EUR750 million, net profit between EUR280 million, EUR380 million, CapEx of EUR750 million, net debt target of EUR4.2 billion.

With respect to the EBIT and net profit targets, notwithstanding the incident in Brazil earlier this year on P55, which, as I said, cost us an additional EUR40 million, we maintain the original guidance due to the positive impact of our new contracts won which will take effect during the course of 2014.

In terms of net debt, there are several factors underlying our ongoing confidence in the target of EUR4.2 billion year -- at the end of the year that I would like to remind you. First, some of the legacy contracts are due to be completed during the year and we expect the pending and final payments for some of these to be made before the end of the year.

It is therefore reasonable to expect a significant easing of our working capital position as a result of the development of our portfolio characterized more and more by contracts with more favorable cash flow profile.

Second, we have attractive commercial prospects which we are confident of converting into backlog over the course of the year. These will bring in additional down payments, further helping our working capital position. Finally, on the basis of the EUR600 million EBIT target, we anticipate generating around EUR250 million of operating cash flow, which will be deployed towards a reduction of debt.

As we have said, we are maintaining our guidance for 2014, but achieving the guidance will depend on a number of moving parts as set out on this slide 16. And now I will take you through them one by one.

First one is the efficient execution of the legacy contract. This chart, 17, shows the breakdown of the E&C backlog at Q1 between lower margin contracts and new contracts awarded since 2013, to be executed in both 2014 and 2015. Looking solely at the existing lower margin contracts, the amount stands at EUR4.3 billion. Compared to year end 2013, there has been a reduction of some EUR600 million as a result of the normal progress of the projects.

As you can see on the slide, the majority of legacy contracts will be executed from the backlog by the year -- by the end of this year, with a small portion amounting to EUR1.5 billion to be executed in 2015.

The other two moving factors are the new order inflow and the time of execution of the new contracts. You will remember this slide 18 from our full-year results in February, illustrating the principal E&C projects up for tender whose award is expected by the year end.

We want now to provide an update on those that Saipem has been awarded during the year to-date. As I've said, in offshore, we won the first line on South Stream and not foreseen in the slide, we are now negotiating the second line job.

In the Asia-Pacific region, Jangkrik FPU has been secured; the floating LNG feed for Masela is not significant in terms of value but still important for potential future developments. In West Africa, Kaombo FPSOs have been awarded solely to us, whereas the SURF, that we bid in joint venture, went to another contractor. In onshore, in April, we were awarded the EUR200 million contract for the expansion of the Versalis plant in Italy.

The evolution of the new awards during the first four months of 2014 confirms Saipem's competitiveness in the key business area of trunklines, FPSO construction and complex onshore projects. We are still competing and negotiating for a number of opportunities listed here and we are cautiously optimistic that we can achieve further awards, particularly in the Americas and in the Middle East, where the projects still up for award play to Saipem's core strengths, both from geographical and technological perspectives.

Timing of award and execution of future contracts will be another important factor towards achieving the high end of our guidance. As far as new contracts win year-to-date, they will provide the limited contribution to 2014 figures.

Just looking at the biggest one, to give you an example, in South Stream the laying activities with Saipem 7000 will start at the end of 2014. Out of the $4 billion of the Kaombo award, $3 billion pertains to a 4 year project where the first phase under execution this year is [mainly engineering]. The remaining $1 billion is related to operations and maintenance activities starting in 2017.

It should also be noted that the portion of order intake year-to-date is represented by change orders of legacy contracts, hence with no contribution to EBIT.

Now moving to slide 19, to sum up. We have made solid progress in the first quarter of 2014 towards stabilizing the business and delivering the recovery. On the legacy contracts, we confirm our constructive ongoing relationship with clients and the continuous progress on execution that will result in the completion of the majority of these low margin contracts by the end of this year.

The strong order intake we have seen in the first quarter has continued into the second quarter and we are pleased that all of these new contracts have terms in line with the clearly stated commercial strategy of this management team.

All of this activity allows us to maintain guidance for 2014 and we remain confident that the foundations are being laid for the return to profitable growth in the medium-term.

On that note, I conclude the presentation, and Alberto and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions).

Phillip Lindsay, HSBC.

Phillip Lindsay - *HSBC - Analyst*

Two main questions please. First of all, it seems that you are much more competitive for lower margin FPU work right now versus, say, higher margin SURF work. I'm trying to get a sense if that's a real trend. As we look into the future, should we expect a much greater proportion of FPU in your offshore mix than we've seen historically? Or do you think -- you still think you'll grab your fair share of SURF and more traditional offshore work? That's the first question.

And the second question is, I really just want to get a sense of your thoughts on strategy around the onshore business. It feels like the competitive environment has got a little easier in the last 6 or 12 months. But I'm interested to hear your thoughts on how you view the competitiveness of your business in the medium-term given your more commercially disciplined approach? Thank you.

Umberto Vergine - *Saipem SpA - CEO*

Okay. Thank you, Phillip. First of all, I would like to say that when we decided to formalize our floaters business as an independent business unit the intention was actually to get going in the business, to identify this business from our offshore and to take the whole advantage of the availability of our yards.

I'm very pleased that actually in very short time we have been able to win three big vessels to be built, one in Indonesia and the two in West Africa, that are perfect to fill up our capabilities both in terms of engineering, management and fabrication.

We are not -- we are aiming to this business as much as we are aiming to the mix of -- what I consider the mix of the offshore without the floaters, that, as you know, is really a blend of SURF, of trunkline, of installation, of medium sized pipeline that we are continuing to pursue with the same interest and the same determination as before. And we are very engaged as our slide shows on trying to win some contract also on the other than floaters offshore business. But I think that this is a very good result considering the capabilities that we have in terms of yards.

On the onshore business, I confirm what I have indicated in the beginning of the year in the previous conference call. We are pleased to see that there are a number of big projects available in the market that has somehow reduced the tension in the competition in between the companies that are normally working on onshore including our friend from Korea. We have been able actually to partner with them in a number of offers, reaching common pricing criteria. And that is something really new compared to few years ago. We are also very close in the (inaudible) in the awarding of some big contracts in onshore and we hope to be the selected winners.

Phillip Lindsay - *HSBC - Analyst*

Okay. And just a separate question on Algeria. Just where are we now in terms of the investigation and can you say whether the DOJ has contacted you at this point? And then maybe where you are in your own arbitration against Sonatrach?

Umberto Vergine - *Saipem SpA - CEO*

Well, we don't have any other development in terms of investigation that we can report. The only new thing is an evolution with the relationship with the DOJ that I will ask Alberto to give you some details about.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes. As you know, with the DOJ, we have signed the following agreement, granting them the rights to enter into investigation if they want to do so without the time expiration from that side. Recently, they send us a request of some documentation on Algeria, which shows an interest from the DOJ on the investigation. The request is a normal request of documentation. We are ready to cooperate with the DOJ on this aspect.

Phillip Lindsay - *HSBC - Analyst*

Okay, very interesting. Thank you.

Umberto Vergine - *Saipem SpA - CEO*

Thank you.

Operator

Fiona Maclean, Merrill Lynch.

Fiona Maclean - *Merrill Lynch - Analyst*

I have two questions. First of all, for the 2015 backlog that you have due for execution, could you give us a breakdown of the amounts per the four segments please? And then secondly, there is a lot of discussion in the market about Kashagan at the moment. Could you just clarify your position? I believe you are out of your warranty period and it's definitely the pipe that's the issue rather than [the work being carried out].

What is your interpretation of the kind of ongoing analysis there and what is the opportunity for you if they were to have to relay the pipe and would you have the capacity to do that? Thank you.

Umberto Vergine - *Saipem SpA - CEO*

I will start from Kashagan. Well, we don't make much interpretation of course about the issue. As you will recall, the scope of work that Saipem executed in respect of this part of the project was the pipes welding and the laying using material and applying working specification either given by the client or approved by the client.

We completed these activity in 2008 and we delivered the project in the hands of the client. We are following but we are not part of the work that the operator is making in assessing the problems that they have to face. We are 100% available to carry out any activity that will be required. And of course as we were able to [foot] lay the first lines, we still retain in the area all the necessary capabilities to do any job similar or repairing of the one originally made.

[To] what relates the breakdown of our backlog by year of execution, I think that we have -- of 2015, as you see in the slide number 9, we provide the breakdown by business unit, where you see that we are progressively -- I mean, we are confirming a general increase in the percentage of offshore compared to onshore in the E&C, while we have benefit of stable business activity in the drilling.

Fiona Maclean - *Merrill Lynch - Analyst*

Okay, thank you.

Operator

Haley Silverman, Barclays.

Haley Silverman - *Barclays - Analyst*

Just a couple of question if I may. First, I was hoping that you could confirm the timing of the future drilling outages in 2014?

Umberto Vergine - *Saipem SpA - CEO*

Sorry. Can you repeat? The timing of drilling?

Haley Silverman - *Barclays - Analyst*

Outages. Just the downtime in the drilling, the timing of those, the remaining ones in 2014?

Umberto Vergine - *Saipem SpA - CEO*

Okay. Let me get to slide -- I want to refer to the slide that we have seen. Okay. So basically if I go more in detail compared -- try to read that -- what was indicated in the slide. On the offshore, we have the number of days either on Scarabeo 7, due to the maintenance work as scheduled we are carrying out, I indicated that there is some extra time associated with this work because we identify some maintenance required of the portion of the rig that normally is under water.

So that was not foreseeable while the rig was on operation. As we took it to the dry docking of course that was visible and this will require basically more than one month more of activity in the yard. We have 32 days on Scarabeo 9 and 94 days on the Perro Negro 7. These are the more significant idle days. Then we have a minor situation like 1 week on the Scarabeo 5 and half a week on Perro Negro 2. But I don't know if this is exactly what you were asking for.

Haley Silverman - *Barclays - Analyst*

Yes, I guess I was just trying to understand if that was all going to be happening in the first half or if -- of the timing around them of the major ones, the Scarabeo 7, Perro Negro 8 or 7?

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes, both maintenance will expire within the first quarter, so the down time expected in the drilling rigs will be in line with last year.

Haley Silverman - *Barclays - Analyst*

Great.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

We do not expect major impact.

Haley Silverman - *Barclays - Analyst*

Great. Thanks. And just a follow-up from Phil around the FPSO contracts that you've been winning. Typically, those are more single-digit margins, and I was just wondering how does using your local contact in Karimun enhance this at all?

Umberto Vergine - *Saipem SpA - CEO*

Well, of course there are always the component of risk mitigation in all the activities that we carried out. The fact that you are able to perform the majority of the work required for the construction of the modules that then will be installed into the hose by our SURF and under our control is certainly a component that generates a lot of responsibility and a lot of direct management of the activity, but on the other side guaranteeing us from the risk of subcontracting particularly at the time when you start having more than one project to follow. The fact that we can organize our yard to work in schedule, in parallel, executing this business is certainly a guarantee for us.

Haley Silverman - *Barclays - Analyst*

Okay, thank you.

Operator

Ryan Kauppila, Citi.

Ryan Kauppila - *Citi - Analyst*

Just two questions from me, firstly on Brazil. There is some industry press that would suggest you guys are pretty well placed on some current tenders there. How would you say Brazil and your new commercial threshold compares to West Africa for similar types of work?

And then secondly, a competitor announced an award on Block 1506 today. Was that a project that you guys bid on?

Umberto Vergine - *Saipem SpA - CEO*

Well, we are not making any [way there] of our commercial strategy on geographical basis in the sense that particularly when we talk about offshore activity being pipe laying or SURF, certainly we tend to compete applying a strategy that commercially doesn't -- is not very different, for example, as you suggested between one side and the other one of the Atlantic.

And we are extremely cautious about the potential risk associated with these activities. And our competitiveness is granted by the fact that we don't believe that there is a tendency to under bid from our competitor for the same -- exactly the same reason. I think that the associated cost and risks will be always well represented by Saipem and I believe that that will not put us out of the market.

Brazil remains for us, is and continues to be a target area, is part of our strategy to growing the offshore, is part of our strategy by which we are completing the building of our yard. And therefore we are still quite determined hoping to achieve some new awards within 2014.

The one that as we indicated on the slide 18. The projects that we are looking at for the area are those indicated here. So I don't know which one you are referring to that you say that today was awarded.

Ryan Kauppila - *Citi - Analyst*

Okay, so if it's not on the slide it's one you probably weren't active on. That's a safe assumption.

Umberto Vergine - *Saipem SpA - CEO*

Okay. Exactly. We were not -- it was not part of our target, key target for the year.

Ryan Kauppila - *Citi - Analyst*

Okay, that's great. Thank you very much.

Operator

Caroline Hixson, UBS

Caroline Hixson - *UBS - Analyst*

My first question is just on the execution of the zero margin backlog. So you said it's EUR4.3 billion for the remainder of the year, which implies it was quite low and your run rate is going to -- has to increase on that through the year. Could you just give some indication of the timing and obviously the impact that's going to have on margins?

Umberto Vergine - *Saipem SpA - CEO*

Alberto?

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes. The execution in the first quarter was actually more than EUR600 million on the legacy contracts because we had also in the revenues and in the order intakes EUR600 million of [variation] orders and amendments to the existing legacy contracts. So we actually executed EUR1.2 billion on those contracts.

Of course we have examined the pace of executing those contracts in the remaining part of the year and we believe that we will be able to complete the remaining EUR4.3 billion. You have also to take into consideration that this first 3 months of the year in some areas is winter season, so it's not easy to progress. Whereas, with the spring and summer of course we will increase the pace of execution on those contracts.

Caroline Hixson - *UBS - Analyst*

Okay, thanks. So the fact that you've had a lot of change orders, does that indicate that it -- equally that EUR4.3 billion could grow through the year or do you know if there is any more change orders to come?

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Correct. You are correct because we are -- as we said, we are in negotiation. We have a lot of clients to make sure that some (inaudible) will be recognized whenever they have bidding called in making good all the execution and operation on both contracts. So I would say that probably in the first quarter we have a big chunk of that, but I would expect some more during the year.

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Caroline Hixson - *UBS - Analyst*

Okay. Can you give the split of that EUR4.3 billion what's offshore and what's onshore remaining?

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes, I think two-third offshore and one-third onshore --

Umberto Vergine - *Saipem SpA - CEO*

Exactly.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

-- roughly.

Caroline Hixson - *UBS - Analyst*

Okay, and just -- and the final, on the offshore margin, so my understanding is your EBIT number includes EUR40 million hit from the Roncador project, which if I back that out, implies something about a 7% operating margin, which seems to me quite high considering you still got some legacy contracts. Does that imply that the underlying is even higher than that?

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Well, we have benefited -- you're right on the EUR40 million actually, the EUR40 million are included. So if you exclude you reach the numbers you have correctly mentioned. We had a ramp up on some more profitable contracts in 2013 like [Gina] is the main one that I would mention. And of course this keeps improving our profit -- our margin on those contracts. So in the offshore in a way we are anticipating a bit the cleaning of our backlog.

Caroline Hixson - *UBS - Analyst*

Okay, thanks. That's all from me.

Operator

Andrea Scauri, Mediobanca.

Andrea Scauri - *Mediobanca - Analyst*

I have a couple of questions. The first one is on orders intake and the target that you have for the full-year in the E&C business. Basically, you have EUR6 billion intake year-to-date. I was wondering if you expect to exceed the EUR10 billion order intake target that you have for the full-year, if I'm not wrong, in the E&C business? This is the first question.

The second question is on the operating margin in the E&C offshore that if adjusted by the P55 project is 7% in margin. I was wondering if once the legacy contracts related to the offshore E&C business are clean what is the level, the sustainable level of operating margin that you have in the remainder -- in the long-term, in 2015 forward?

And the very last question is on South Stream. Could you quantify the size of the down payment that you expect in second quarter? Thank you.

Umberto Vergine - *Saipem SpA - CEO*

Thank you, Andrea. First of all, on the issue of what we expect to be our order intake this year. Well, we hope to exceed, and to exceed with good contracts our target of course. Our slide 18 really represents the whole range of targets that we have. We are very pleased of the results of this first four months and we are moving towards the direction that could guarantee reaching our objective.

And certainly, if the quality of our offers will be well seen from our client, we can even exceed that. I think that this is -- this will be the best indication of how quickly, how solid will be our recovery. At this moment of course, as you can imagine, I can't make any speculation about this. But I think that we will take account of the good result achieved so far.

Andrea Scauri - *Mediobanca - Analyst*

So basically EUR10 billion is a reasonable target, remains a reasonable target that could be exceeded, if I understand well?

Umberto Vergine - *Saipem SpA - CEO*

It could be exceeded. But again, this is a matter that remains really open until it gets closed, because until the last minute you have no guarantee that even what you believe to be your best position eventually materializes. So really this is a matter that speculatively it can be very positive, slightly positive or neutral. I still remain neutral.

Andrea Scauri - *Mediobanca - Analyst*

Okay, okay. Thank you.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

I will answer on the operating margin of offshore. Of course there are so far good signals in this respect, so we are improving our margins. And this is thanks to the -- I would say the acceleration of the cleaning of the backlog, which is good. And as we have always said in the offshore we consider acceptable margins, double-digit, more than 10%. They rise [above] also depending if it's (inaudible), if it's SURF, if it's trunklines or PNI. But overall it's a positive double-digit margin.

So I would say that the signals that we are receiving from the strong commercial momentums are very good if you look them in terms of -- in medium-terms perspective. From 2015 onwards we will certainly benefit (inaudible) margin.

The South Stream down payment is EUR140 million and will be received in the second quarter of this year.

Andrea Scauri - *Mediobanca - Analyst*

Okay, many thanks.

THOMSON REUTERS

Operator

Robert Pulleyn, Morgan Stanley.

Robert Pulleyn - *Morgan Stanley - Analyst*

Just two questions from me. Firstly, Saipem has spent an enormous amount over the last 10 years investing in what seems like a best in class asset base and a lot of local content. Are you still confident that in what seems to be the new market outlook that there's going to be enough volume of contracts coming through to maintain a good level of utilization across that large best in class asset base? Or perhaps are some of your assets in yards and local content going to be underutilized?

And the second question is much shorter and much simpler and it relates to drilling rates. Did I hear you correctly saying you are expected to get more favorable rates on the rigs which are coming up for contract rollover? Thank you very much.

Umberto Vergine - *Saipem SpA - CEO*

Thank you. Well, certainly the fear that I received from the market at the beginning of last year of Saipem, being as a result both of the Algerian investigation and the surprising low performance being able to secure sufficient work to give enough job to do to our fleet and to our yard seems to ease out quite rapidly, particularly with the current wins -- but not only because of their value, but their nature.

I mean the type of business that we are winning is exactly the type of business that Saipem has to win in order to extract the best possible of its strategy. And the strategy, as you rightly said, goes through status of the yard fleet and huge yards, always going in that direction. If you look at the installation, if you look at the FPSO, I hope that we will be able to secure more activity of this nature, not necessary just on FPSOs, but even on some activities related to LNG in order to supplement this.

Certainly, I start to see a much easier situation for the next 2-3 years. Certainly, just to wrap up, really what is my thinking at the moment, if we will be able to secure in short time some more onshore projects to execute, we will secure our activity for the next 2-3 years also on the E&C onshore. And then I think that we will be back on a level of engagement with the market very similar to the successful one of 2010, 2009, et cetera.

Your second question was in relation to --

Robert Pulleyn - *Morgan Stanley - Analyst*

Drilling rates.

Umberto Vergine - *Saipem SpA - CEO*

Oh, to the drilling rates. Yes, I said that we are expecting some slightly better rates on some of the onshore rigs and on some of the jack-ups. There is a certain trend of decreasing rates for the top end of the semi-sub for the ultradeep activities, also because there is expectation of the new rigs, the new build coming in.

The mid range and the lower or medium half lower range is still quite -- the market is still quite tense, because at the end of the day there is no much more number of rigs coming in and the market is still busy in using lower deepwater semi-sub and jack-ups. So on that one we don't expect to see any reduction in rates, possibly a slight increase.

Robert Pulleyn - *Morgan Stanley - Analyst*

Okay. Thank you very much for the color.

Operator

Luigi de Bellis, Equita SIM.

Luigi de Bellis - *Equita SIM - Analyst*

Two questions from me if I may, the first one is on the net debt guidance. How much is the expected [cash in] from the unwinding on working capital expected in 2014 excluding the down payment? The second question is on the full-year guidance. During the presentation and looking into your guidance for operating cash flow, you mentioned the EUR600 million of EBIT. Do you think that the high end of the guidance is now still achievable or is out of the scope? Thank you.

Umberto Vergine - *Saipem SpA - CEO*

Well, I comment on the guidance. Then I let Alberto to give you what he thinks about the working capital. I think that is -- if you remember when we presented our guidance, we indicated a base and a high and we said that the base -- reaching the base was already conditional to a certain level of order intake of contract of a required quality and this is what we have achieved today.

So I think that in many respect we can say that even despite the issue of the P55 we have somehow secured the low end of the guidance. In terms of new order intake and the number of months during which this new contract could be won, and therefore the possibility to impact on the revenues and on the performance of 2014, I believe that we have not finished here.

So if we will be able to win more contracts between now and the year end, that could help our result to move towards the high end. And again, that is depending of how much, how many and how soon.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

And about the working capital unwinding, if we want to reach EUR4.2 billion, which is our maintained objective on net debt at year end, we have to find to improve our cash flow of EUR1.4 billion, of which EUR1.1 billion approximately is unwinding of the working capital.

Of course there are -- the elements of unwinding of the working capital have already been stated by Umberto. I would like just to add that on the down payment issue we do not see any criticality based on the order intake to recover the EUR110 million that we have lost in this quarter. And as well as in the milestone is a technical element, so we believe that the approval of the milestone should be much more favorable in the second half of the year.

The remaining two issues, they are very much linked with our ability to negotiate with the clients. And this is the target of the Company and this is the area where the full -- the project managers and project directors and the top management is fully engaged at the moment.

Luigi de Bellis - *Equita SIM - Analyst*

Is it possible to have an idea of how much is the percentage related to the negotiation on the EUR1.1 billion?

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes. It's what we have stated EUR90 million. We have to recover EUR90 million in terms of operation orders. And then we have another EUR220 million, EUR250 million that we want to improve in terms of trade receivable.

Luigi de Bellis - *Equita SIM - Analyst*

Thank you very much.

Operator

Henry Tarr, Goldman Sachs.

Henry Tarr - *Goldman Sachs - Analyst*

I had a couple, firstly just to come back on to the Kaombo project award. Did you specifically prioritize the FPSOs over the SURF package on that one? I think the industry articles had you as a lower bidder on the SURF package as well. And then did you see the client pushing back on price on this particular contract? I know Total have been vocal about lowering costs on that contract.

And I have a couple after that. But I will leave that for now.

Umberto Vergine - *Saipem SpA - CEO*

Well, we submitted the offer for the whole job, both for the FPSO and for the SURF. For the SURF we were in partnership. Here we are on our own, 100% Saipem. And certainly we have not prioritized our offer. Our SURF is always a target important. And on the other side, we have not made -- we have not to apply discounts in order to win the FPSOs.

As you recall, the awarding of this contract has been pending since a number of months. This has been purely the decision of the operator of the client that after having received the initial offer decided to review the scope and the specification of the project in order to reduce the cost. And on that basis all the companies submitted the offers.

So the reduction in cost that Total -- because we know that is Total the client, has been able to achieve its base not a commercial discount but on a thorough and extremely smart approach that they had in order to minimize the cost that initially they discovered they would have had to face based on how they structure the tender initially.

Henry Tarr - *Goldman Sachs - Analyst*

Okay.

Umberto Vergine - *Saipem SpA - CEO*

(Inaudible) or I left something out?

Henry Tarr - *Goldman Sachs - Analyst*

No, that's very helpful. And then just a couple of other questions on -- firstly on the timing for South Stream and the second line. Do you have any visibility on when and if that might move ahead? And then could it be of a similar size to the first award or -- I guess there may be efficiencies from doing the second line.

And then just lastly on Wasit and the working capital milestone issues. Just to confirm, there's no problem with the client here or the ongoing scope of work. It's simply that you haven't hit milestones in this quarter and you fully expect to hit them in 3Q and recoup that money?

Umberto Vergine - *Saipem SpA - CEO*

Okay, on South Stream, the client is still determining to continue going ahead, identifying the best way to execute the remaining three lines. So we are now discussing with them for the second of these four lines in order to first identify -- verify availability of vessels and particularly schedule in spite -- I mean, in consideration that they are targeting the completion of the second line quite soon.

I mean, they have to be able to get the second line finished around the end of 2016, so you understand that they are moving ahead quite quickly now. We are in discussion with them in order to understand how much we can be part of that, if our costs are acceptable to them, considering of course the role that we are already having on the first line.

Yes, finish it --

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes. On Wasit, the issue with Wasit is an issue linked with the terms and condition of the contract. Basically, we are incurring at the moment a lot of cost, especially -- specifically in purchase of material that will be utilized in the project. And unfortunately -- I know that it's not a nice thing to say, but unfortunately we accepted very penalizing terms in this contract.

And Saudi Aramco is strictly respecting those terms and condition of the contract. So not doing anything more than applying the terms and condition of the contract. We believe that there will be an unwinding because this purchase of materials and other costs that we are incurring will be recognized in milestone during the year and this unwinding will be especially stronger after the immediate midyear, after midyear, so in the second half.

Henry Tarr - *Goldman Sachs - Analyst*

Okay, very helpful. Thank you.

Operator

Guillaume Delaby, Societe Generale.

Guillaume Delaby - *Societe Generale - Analyst*

When I look at your accounts 2013 and Q1, it's very difficult for analysts to have some comfort with your guidance with what you are saying. And I'm just looking at -- I'm sorry, it's a little bit of an obsession with me, but if I look at your staff cost in 2013 I can see that they have increased by roughly 15%. This increase continues in Q1 2014. Do you have a plan maybe to try to reduce those staff cost as one of your competitor has been successful doing that in 2013? Thank you.

Umberto Vergine - *Saipem SpA - CEO*

Sorry --

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Staff cost, no?

Umberto Vergine - *Saipem SpA - CEO*

-- we could not fully understand. You are referring to which cost?

Guillaume Delaby - *Societe Generale - Analyst*

Staff cost. Payroll and related cost increased by 15% in 2013.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes, there is an explanation. You are right. And it looks a bit odd, but there is a clear explanation for that, because we had to convert a lot of contracts, namely the one in Mexico and Canada where we had bad performances of subcontractors into direct hiring of the people. So we got rid of the subcontractor and we maintained the people of the subcontractor under direct hiring of the Company. So this is the main explanation of the difference.

Umberto Vergine - *Saipem SpA - CEO*

I would like to add that of course all this personnel is normally hired on the project. So the cost that we see on this personnel cannot -- should not be mixed with the cost of the permanent staff.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Yes.

Guillaume Delaby - *Societe Generale - Analyst*

Okay. Does it mean that staff cost is going to be stable or maybe slightly go down in 2014 or can we have some color about that?

Umberto Vergine - *Saipem SpA - CEO*

I can tell you this, out of -- let's refer to the Italian staff, for example. In terms of the Italian staff we have about 7,700 people. Last year, we had a net increase in the range of 70 people I believe, and for this year we are planning more or less the same. If I look at our engineering centers, we have in general variances that are of this percentage of this size.

Where we have big variations are in the international staff. The international staff grows with the projects. More backlog, more people; of course less backlog, less work to do and less people. So that are two phenomenons. One is impacting somehow your staff cost, your G&A. The other one is a cost that is built in in the price that the contract -- certainly, there is always a mix between costs that are not seen as a subcontractor and costs that are visible because we do direct hiring. And mainly we employ supervisors. But sometimes like the cases that Alberto mentioned, we employ the full crew because we had to improve the quality of their work.

Guillaume Delaby - *Societe Generale - Analyst*

Okay. Thank you.

Operator

Geoffroy Stern, Kepler Cheuvreux.

Geoffroy Stern - *Kepler Cheuvreux - Analyst*

Actually, I have a couple of questions. The first one, just to come back on the offshore E&C business. So as has been said before, the underlying margin in Q1 was close to 7%. If I remember correctly, a couple of months ago you guided for the margin of offshore E&C to be at 4% this year. So is there any reason to expect the underlying margin in the coming quarters to be at such a low level?

And just I want to clarify also some of your comments about the trend in terms of -- for the offshore E&C margin going forward. I think you said that the margin should be a solid double-digit, let's say, in the medium-term. But did you say as well that you expect the margin to be at 10% next year? I just wanted to clarify that. And then I have another question, but I will stop here.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Okay. Well, on the offshore, yes, you are right that when we presented the budget the offshore margin showed at 4% around, and we had an improvement. You have to take into consideration that we have some of the legacy contracts and then we -- the impact of the new contracts was much better, and was much better because of, let's say, there has been a good ramp up on some profitable contracts, and I mentioned the Gina. So in a way, as I said, there's an acceleration of the cleaning.

In terms of -- I probably didn't catch exactly your question on the margins on the offshore. We said double-digits. And we said that in 2015 I would expect that we will stay only with a couple of big legacy contract like Wasit for example, which is an offshore contract with a big margin. But I would expect the offshore business segment to pick up also in terms of margin.

Geoffroy Stern - *Kepler Cheuvreux - Analyst*

All right, thanks. And then I have a question with regard to offshore drilling. So you commented about the extended maintenance of Scarabeo 7 impacting the performance of the offshore drilling business. So the EBITDA margin was 50% in Q1, which is quite low compared to the previous years, I will say. Is it fair to assume a pickup to the 43%, 44% -- sorry, 54% you have achieved for the past few years as of Q2?

Umberto Vergine - *Saipem SpA - CEO*

Yes, we expect a slight improvement. And the fact that we have this situation with the Scarabeo 7 of course is the reason of this slight increase compare book to budget, (inaudible) book to budget and to 2013.

Geoffroy Stern - *Kepler Cheuvreux - Analyst*

All right. Thanks for this.

THOMSON REUTERS

Operator

David Farrell, Macquarie Group.

David Farrell - *Macquarie Group - Analyst*

Two questions from me please, firstly in terms of the insurance claim on the Perro Negro 6. Could you tell me what the size of that is and when you expect that to come through in terms of the cash flow and its contribution to the reduction in net debt? And then secondly in terms of the onshore E&C business I was wondering if you could give a little bit more color on when you expect a positive operating profit contribution from that division? Thanks.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Okay. In terms of the insurance, it has been already cashed in. So we fully recovered the value of the Perro Negro 6. And it has been cashed in last year, so we will not benefit of any cash flow inflows this year from this full insurance. What the insurance is now dealing with is the wreckage removal. This will be based on a contract that if accepted by the insurance will be fully managed by the insurance. So the insurer will manage the wreckage removal and we are pretty confident that we will not incur any excess cost based on the first assessment that we make.

Is there another question?

David Farrell - *Macquarie Group - Analyst*

Yes, sure. The other question was when the onshore E&C business is likely to deliver a positive contribution?

Umberto Vergine - *Saipem SpA - CEO*

I mean we have indicated, which is our view for this year. And we hope that with the revenue target that we have indicated, if that would increase, this could accelerate of course the recovery in margin or it will be next year.

David Farrell - *Macquarie Group - Analyst*

Okay, thanks.

Operator

Thank you. And it appears we have no further questions at this time, sir.

Umberto Vergine - *Saipem SpA - CEO*

Okay. Thank you very much.

Alberto Chiarini - *Saipem SpA - Chief Financial and Compliance Officer*

Thank you.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.