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SPM.MI - Q2 2017 Saipem SpA Earnings Call

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JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

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PRESENTATION

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

Good morning, ladies and gentlemen. Welcome to our first half 2017 results presentation. I'm here today with Giulio Bozzini, our CFO; and our divisional directors, Stefano Porcari, Marco Toninelli and Mauro Piasere, in charge of, respectively, our Offshore E&C, Offshore Drilling and High Value Services division, as per our new organization fully in place since early May. They will answer any question you may have at the end of the presentation. Unfortunately, G.G. Caselli is not able to attend today due to business commitments.

I will start today by highlighting our operational performance. Over the first half of 2017, we delivered a good operating performance, especially in E&C Offshore, resilient offshore drilling margins and strong operating cash flow. This was despite the challenging market environment that the industry continues to face and is a result of our continued efforts to improve efficiency, reduce costs, control working capital and our constant attention to execution.

Revenues amounted to EUR 4.6 billion in the first half of 2017 and our adjusted EBITDA was at EUR 524 million, resulting in a margin of 11.4%. Our E&C Offshore division performance was strong as ongoing projects execution progressed better than expected. And in our E&C Onshore division, the margin recovery trend is in line with our plans, while floaters performance was penalized by acceleration cost in Kaombo project.

Offshore drilling performance in first half has been supported by some long-term contracts, many of which were negotiated in a very different environment than today. However, the onshore drilling business continued to suffer the effects of the downturn in certain geographies, especially in South America.

Looking ahead into second half of 2017, we expect the E&C Offshore and Onshore division to grow revenues versus first half 2017, as a result of project execution schedules and additional change orders. The reported result is affected by special items, including mainly net provision for redundancy, tax litigation settlement and asset write-downs, on which Giulio will expand later.

An improved cash flow generation from operation as a result in a reduced -- in a reduction in net debt over the quarter, down by EUR 100 million versus the first quarter and now standing at EUR 1.5 billion.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Our contract backlog stands at EUR 11.7 billion as of the end of June, with circa EUR 1.6 billion of orders awarded in the second quarter. This new order intake was lower than we had previously anticipated, primarily because many of the initiatives which we are targeting in the near term have been subject to delays for various reasons. I'm though, convinced about new significant works to materialize in the near term both in E&C Offshore and especially in E&C Onshore for a total of at least EUR 4 billion.

Turning briefly to our efficiency initiative. In June, we almost reached the EUR 750 million run rate savings identified in the Fit for the Future program. And by the end of third quarter, we expect to meet our EUR 1.7 billion cumulative saving target.

Talking about the more recent Fit for the Future 2.0 program. We now start seeing the positive effects of the new organizational structure, which became fully operational in May 2017. And in addition to 800 redundancy plan announced in October 2016, the division has identified a further 350 redundancy, bringing the total to 1,150.

We have decided to scrap 3 of our oldest vessels, reducing the present cold stacking cost, while the next phases of the divisional processes tailorization and streamlining are expected to deliver additional benefits to our cost base, which we'll update you with over the next quarters.

As a result of these Fit for the Future 2.0 program initiatives, we have good visibility on a target of gross annual savings of around EUR 110 million by 2019. We believe these difficult choices and actions will allow us to better compete in the new market context and to benefit from the expected future up cycle. Despite the outlined progress, we have had to adjust our revenue guidance to EUR 9.5 billion to reflect a lower-than-expected order intake year-to-date and the adjusted net profit guidance to EUR 200 million due to higher financial expenses. However, thanks to the improving operating performance and the sound cash generation, our guidance for both EBITDA and net debt remains unchanged.

As I just mentioned, the new organization is now in place, and I'm pleased to present you the heads of our 5 divisions, as you can see on the slides. They are all experienced professionals, serving the company for many years and covering various key position across our business and geographies, while our new onshore drilling director will soon join us from outside. They've been actively participating to the organization program and are currently committed to adopt the business to the current market context, in order to fully exploit the divisions' commercial and operational potential. Later on, I will spend a few words on our reorganization, highlighting the improved accountability of the new divisions and the streamline role of the corporate.

But it is important to note that the new structure is now in place in operation, that we have appointed the relevant heads of division and identified further cost savings.

I wish to draw your attention to the fact that our floaters business, which includes both leased FPSO contracts and the floaters, EPC project, and which was previously included in our E&C Offshore business unit, will now be included in the E&C Onshore division, on the account that the relevant set of competencies and project management skills are more in line with those of our E&C Onshore business.

Regarding the High Value Services, which in a start-up phase, I wish to remind you that this new division is aimed at strengthening the set of services we provide to the oil and gas industry and achieving a much earlier engagement with our clients.

I will now hand over to Giulio to talk through the first half financial performances in more detail, and then I will comment on our business outlook, recent awards, the backlog and the new efficiency actions implemented to date. Giulio, over to you.

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

Thanks, Stefan, and good morning to all of you attending our presentation today. First of all, starting from this quarter, the economic performance of the divisions are reported consistently with the new organization. The main difference derives from floaters activities, previously part of the E&C Offshore and now included in the E&C Onshore division. We have decided to provide separated floaters results in order to allow an easier transitions towards new numbers. However, the new E&C Onshore division can be easily derived by adding floaters and E&C Onshore. High Value Service numbers have not been reported separately since in start-up phase. The new organization is also, in some instances, affecting allocations of costs



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

between divisions, therefore impacting quarterly comparison. In this regard, first half 2017 results are more indicative than those of the first and the second quarter of 2017.

First half revenues decreased by 13% versus first half 2016 due to lower activity in E&C Offshore, floaters and drilling. As anticipated, both E&C Offshore and Onshore are gradually increasing quarter-on-quarter, according to the different phases of project execution. And this trend should continue in second half. Drilling segment is stable quarter-on-quarter. However, offshore drilling is expected to decrease in second half due to higher idleness, although this trend will be mitigated by Scarabeo 9 lump sum for contract-specific rig modifications. Mainly as a result of the weak first half order intake, we have slightly review downwards full year revenue guidance.

Turning to profitability. In this slide, I will comment on adjusted figures, whereas reported results will be commented in the next slide. Overall, EBITDA margins were better than expected, allowing us to reiterate full year EBITDA guidance despite revenue decrease. E&C Offshore margins were healthy as a result of good operational efficiency and lower idleness. E&C Onshore margin were stable with no major events to highlight. Floaters margin were penalized by the Kaombo project due to higher cost in Karimun base stemming from additional program acceleration as well as to withholding tax costs. This deterioration was only partially offset by other projects.

With respect to drilling, I would first like to point out that first half 2017 results are more indicative than quarterly results given some changes in allocation of costs resulting from the new organization. That being said, drilling offshore percentage margins were extremely resilient. I would always remind you that results are still partially backed by long-term contracts negotiated in significantly better market environment. As rates are renegotiated, they will align to current market conditions. In addition, second half is expected to be penalized by higher idleness, mainly relevant to the semi-sub Scarabeo 5. Drilling onshore margins continue to be penalized by depressed South American activity. First half margins were also impacted by start-up costs in Kuwait and Argentina.

With regards to adjusted net profit, financial charges were penalized by exchange currency loss, resulting mainly from the significant devaluation of the U.S. dollar in the quarter. As a matter of fact, despite we hedged the vast majority of our foreign exchange risk, we have residual exposure to unforeseen variations in position at risk denominated mainly in U.S. dollar. Tax rate was in line with expectation.

First half 2017 reported results include the following special items: Provision for redundancy as a result of the reorganization of the group, which Stefano will comment in Slide #23, totaling EUR 26 million net of tax. Tax settlement concerning year as 2008 and 2009 – year as and year up 2010 and 2011, as described in our press release dated May 26, 2017, totaling EUR 79 million. Write-downs, associated with asset rationalization and impairment test, totaling EUR 97 million, this amount is resulting mainly from 2 elements: the increase from 7.2% to 7.8% of the discount rate applied to future cash-generating unit cash flows for impairment tax exercise, triggered by the first half 2017 increase of the Italian government bond interest rates; and secondly, the decision to fully write-off Scarabeo 5 after the failure of the negotiation for renewal with Statoil in the North Sea. Consistently with the above, first half 2017 net result goes from an adjusted profit of EUR 92 million to a reported loss of EUR 110 million.

Net debt at the end of June 2017 amounted to EUR 1.5 billion, decreasing from EUR 1.6 billion recorded at the end of March 2017. As anticipated, since October 2016 call, first half 2017 net debt evolution was affected by the distribution of cash associated to project joint ventures. In addition, the tax settlement impacted second quarter 2017. Overall, these nonrecurring items totaled approximately EUR 340 million in first half, of which EUR 250 million in the first quarter 2017 and EUR 90 million in the second quarter 2017. Taking that into consideration, net debt trend is encouraging. The decrease in excess of EUR 100 million in second quarter gives us confidence in reiterating our net debt guidance for 2017. Overall, the cash flow generated in first half more than offset CapEx, which continues to be strictly monitored, targeting additional optimization. Working capital dynamic was broadly in line with our expectations, and working capital management remains one of the key aspects to meet our full year guidance.

In last presentation, I mentioned that Saipem permanent financial structure was reinforced by the additional bond tranche and by the additional credit facility guaranteed by Atradius, Dutch export credit agency. This slide summarize our financial profile as at 30 of June 2017, characterized by an average debt maturity of 3.5 years, no significant amounts to be reimbursed in 2017, 2018 maturities more than covered by the undrawn export facilities guaranteed by GIEK and by Atradius, available excess cash amounting to EUR 1.3 billion versus EUR 900 million at the end of 2016, a committed revolving credit facility of EUR 1.5 billion expiring in 2020 as well as few uncommitted credit lines for treasury purposes. The work done was appreciated by credit agencies. Moody's confirmed last June it's Ba1 rating with stable outlook. And Standard & Poor's reaffirmed its BB+ rating with negative outlook, but improved the company's liquidity profile to strong from adequate as a result of the improved debt maturity



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

profile and of the sizable amount of cash on the balance sheet. The recent renewal for 1 year of the program for issuance of nonconvertible notes, EMTN program, is aimed at granting additional flexibility to further strengthen our financial profiles.

We constantly review our financial profile. And in order to improve the utilization of excess cash and committed lines as well as optimizing the utilization of export facilities, we have decided to first draw the Atradius facility for the total amount of EUR 225 million, and secondly to utilize part of the excess cash for an amount of EUR 300 million to prepay another portion of our term loan. In this slide, we summarize our financial profile following such actions, which will be completed by end of July. In particular, the term loan outstanding is reduced from EUR 1,100,000,000 to EUR 575 million, and the average debt maturity increased to 3.9 years. In addition, financial interest will be slightly reduced, and the banking capacity freed through the prepayment will be used for the negotiation of new bilateral lines, enhancing the flexibility of the financial structure and diversifying the funding sources.

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

Thanks, Giulio. Let's now move to our business update section. Uncertainty over the timing of the FIDs by our clients is still impacting the timing of CapEx recovery. As a consequence, cost cutting and efficiency efforts by contractor as well as industry consolidation and alliances among preeminent players are likely to continue for the foreseeable future. However, countercyclical investment strategies by certain NOCs are still supportive, especially in certain areas of the downstream market as well as non-oil-related and non-CapEx-related segments.

In addition, selected short-term Onshore and Offshore E&C opportunities are visible, despite markets are not yet in recovery mode. Overcapacity in the global offshore drilling fleet persists, and day rates are still bottoming in 2017 despite strong attrition on all those assets.

Finally, despite a good visibility in the Middle East onshore drilling activity, the South America market remains depressed. During the first half, order intake suffered from the current market context, and the backlog level now stands at EUR 11.7 billion. However, we are encouraged by the promising visibility on several attractive project opportunities, and we remain confident in significant awards over the next few months.

Regarding the actual first half revenues to the remaining backlog for the current year, we reached a level of backlog coverage of circa 88% of our revised 2017 revenue target, historically in line with where we would expect to be at this point of the year. Please note that, although small, a contribution to 2017 revenues is expected with regard to certain near-term opportunities both in E&C Offshore and especially in E&C Onshore. We expect to see an increase in visibility also on 2018 revenues, thanks to such new opportunities on which I will elaborate later on in a dedicated slide.

Let's now take a deeper look at our recent awards starting with offshore drilling. As you know, those initiatives we'll flag to you in our first quarter presentation were successfully awarded and announced to the market during the second quarter. We have been awarded a long-term contract with Eni for drilling services in the Coral field in Mozambique to be performed with our Saipem 12000 drillship. The scope of work entails the drilling of 6 wells under firm period of 15 months, starting from the second quarter of 2019 and options up to an additional 45 months. Contractual daily rates for the firm period are consistent with the current prevailing rates applicable to this type of vessel and service location, while the optional period day rates benefit from a gradual contractual escalation up to much higher levels. This new initiative follows the other agreement on the Saipem 12000, announced in our first quarter '17 presentation for a set of commitments in Cyprus and Portugal in early 2018. We are now actively pursuing various opportunities in the Mediterranean Sea and East Africa to employ the vessels also before the start of the Mozambique campaign.

The other contract awarded in the second quarter relates to Scarabeo 9, which will be employed to drill 1 well plus an optional well for a second one in the Black Sea, following the execution of vessel modifications required to enable the transit under the Bosphorus bridges. Such modification, together with mobilization fees, will be paid on a lump sum basis by our client. Works are already progressing in order to enable the start of the drilling campaign by the end of this year.

Meanwhile, we are also actively marketing the vessel in order to capture other opportunities while the Scarabeo 9 is operating in the area, leveraging on the fact that the demand can now benefit for a first-class vessel able to operate in the Black Sea. These contracts help underpin our near-term outlook for 2 of our major vessel and for the Saipem 12000 provide a greater visibility of our revenues for 2019 and 2020.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Among the awards announced with respect to E&C, the most significant one is the SURF package for the Liza or Liza project in Guyana with ExxonMobil. And we are excited to participate to the first oil and gas developments in the country. Interesting for this initiative, the client require contractor to tender through both the traditional separate packages offer as well as an integrated solution. The decision taken at the end of the process was to favor the traditional supply scheme, under which our offering resulted as the most competitive solution for the SURF scope of work. The EPC contract scope of work of the Liza project includes flowlines, risers and relevant structures. The T&I of umbilicals and manifolds and associated foundation for production and injection system, which will be installed by the FDS2 and the Normand Maximus in 2019.

During the second quarter, we were also awarded 2 other packages for conventional fixed facilities under the LTA agreement with Saudi Aramco. Overall, the scope includes EPC and T&I for 19 jackets pertaining to various offshore fields. It is also worth mentioning the 3 years extension up to 2020, plus 1 optional year of the Gimboa-leased FPSO contract in Angola for Sonangol.

The longer downturn is still affecting investment decision by our clients. However, based on the negotiation evolution, we expect to receive positive news in the near future on a number of new initiatives, and we decide it was worth highlighting them in a dedicated slide. Obviously, we shall not be awarded all of them, but we expect to collect an overall amount in excess of EUR 4 billion in the near term.

In the E&C Onshore environment, which have seen very few awards until now, we are participating through a number of promising initiatives in various segments from upstream to downstream and infrastructures. In the downstream segment, we are waiting to be informed about the outcome of the tender process for the Duqm Refinery in Oman, where we have participated in all 3 packages. In the upstream, we also expect some progress with reference to the new refinery pipelines project in Kuwait for KOC. In West Africa, we are also tendering the second phase of the Okpai Power Plant, which we built several years ago.

Regarding the infrastructure segment, following the recent Italian Inter-ministerial Committee, compulsory investment approval as part of the contracting consortium, of which with all the participation of 51% and the leadership, we are in the process of finalizing with the client the contract for the second section of the Milan-Verona high-speed train.

Regarding offshore, we are continuing the negotiation for the ramp-up phase of the Zohr project in Egypt, which follows the early development phase we were awarded last year and which is presently under execution and progressing well on schedule. These new opportunities result not only of our continuous engagement with our client, Petrobel, but also a different EPCI fast-track approach we have agreed to follow with our client, an approach we see supported by the excellent performances of our fleet and project team. Works under this new contract will be partly executed in parallel with the current ongoing early development. We are also expecting new additional work orders to be assigned during the second half of the year under the West Hub project in Angola, which should be partly executed in 2017 in continuity with other ongoing activities already committed. Finally, we are bidding for some other packages of the conventional fixed facility works under the LTA agreement with Saudi Aramco.

As you know, our bidding pipeline is much broader than the initiative that I have just highlighted. And in this usual slide, we list the selection of initiatives in E&C which we are tendering or negotiating with our clients. As you can see here, despite the persisting downturn, many initiatives are still on the table of our clients and waiting for FID. As you know, several of these projects are expected to be sanctioned not before 2018 that keep our commercial department very busy. The total value of these opportunities stands at over \$40 billion.

We have update the schedule of our drilling offshore fleet to reflect the recent acquisition I have highlighted previously. In terms of opportunities in addition to what I've already mentioned regarding the Saipem 12000, the Scarabeo 9, we are marketing the Scarabeo 8, which is committed until the end of the year for initiatives in Russia and in the North Sea. For Scarabeo 5, the negotiation for the contract renewal ended in June and successfully. And at the moment, we have no visibility on other bidding opportunity. Since we need to decide also whether to execute the cyclical maintenance on the asset in the current market context and in the absence of visible opportunities, we have decided to write-off the residual book value of the unit. However, we remain convinced about the capabilities of the asset and of its ability to deliver high-quality drilling services to best-in-class clients. Therefore, we are pursuing alternative contractual schemes involving the vessel in partnership with our players in the market. By the end of the year, we'll take a final decision on the future of this asset depending on the outcome of the ongoing conversations.

Regarding the Perro Negro 8, currently idle, we are offering the unit in the Middle East and in the Pacific area. Finally, we have taken the difficult decision to scrap the Scarabeo 6 and the Perro Negro 3, both completely written off last year.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Moving to the onshore drilling. The weighted average utilization rate of our rig fleet was stable since the first quarter at 56 -- 57%. In terms of our onshore drilling portfolio, where the Middle East continues to provide stability, the situation in Latin America remains difficult. The only country on the continent which shows visible prospects is Argentina, where we continue following the market. We are in discussion for possible opportunities. We are also pursuing shorter-term initiatives in the Caspian region and in North Africa.

Let's now have a look at our efficiency initiatives. Let me show the slide for last time. As anticipated, at the end of June, we have almost reached the EUR 750 million run rate savings target identified for 2017 in the original 2015 Fit for the Future program. And by the end of the third quarter, we expect to meet our EUR 1.7 billion cumulative savings target.

Moving to the more recent Fit for the Future 2.0 program. As anticipated at the beginning of today's session, the new organization with the 5 divisions is now fully operational with all relevant, commercial, engineering, procurement, technical, staff functions directly reporting to the respective heads of the division. These new structured targets, a higher accountability, efficiency and efficacy of the divisions through autonomy in identifying priorities and targets and agility in decision-making, stronger management focus on project operational performance using all the business levels to deliver, customization of the organization structure and processes in line with the different business-specific needs, direct responsibility on the relevant operational resources and staff functions with the commitment to target a leaner and cost-effective organization. The new organization will also provide an increased strategic optionality. We are now seeing the first positive effects of the new organizational structure. The 800 redundancies, which we announced in October 2016, are on track, both in Italy and France, and the overall schedule of the program has been accelerated and should be completed by 2019, accounting cost already in 2017.

In addition, during the first 2 months of the new organization, the original 800 redundancies plan has been increased by 350, a 44% increase. As a result, the overall identified redundancy level in Europe is now around 1,150 resources between 2016 and 2019. The overall run rate savings identified in this phase is in the range of EUR 110 million per year coming from redundancies and vessel scrapping, such as Perro Negro 3, Scarabeo 6 and Castoro already fully written off. The overall cost of the redundancy plan is around EUR 190 million to be mainly accounted for between 2017 and '19, of which around EUR 60 million already in 2017.

I would like to emphasize that the optimization exercise by the division is still ongoing, and we expect to deliver additional benefits to our cost base and overall efficiency. I will continue to update you in due course in the coming quarters.

To conclude, I believe such action -- actions will enable Saipem to be very well positioned to compete in the new market context and to better benefit from the expected future upside -- up cycle.

Regarding guidance. Revenues for 2017 are now expected at around EUR 9.5 billion, mainly due to the revised timing of new contract awards. EBITDA is confirmed in the range of EUR 1 billion with a margin increased to above 10%. Adjusted net profit is estimated at approximately EUR 200 million compared to the previous estimate of EUR 230 million due to increased financial expenses. This does not include special items, specifically reorganization expenses, tax claim settlement and asset write-downs, which in first half 2017 amounted to EUR 202 million. We are targeting CapEx below EUR 0.4 billion, and we are continuing to work hard to control and optimize this amount. Finally, net debt is confirmed at around EUR 1.4 billion at the end of the year.

To conclude, I'm glad to say we delivered a strong operational performance in first half of 2017. As of the half way of the year, we have also made further progresses -- process in strengthening our capital structure, increasing our debt maturity profile. Our sound operating cash flow generation allowed us to reduce net debt in the second quarter despite the impact on nonrecurring items. Better focused divisions and greater flexibility are delivering tangible savings expected to gradually benefit future result, while near-term awards are expected to increase visibility on future revenues. So whilst we continue to face challenges, I believe that at Saipem we are well positioned to benefit from the future industry upturn. Thanks to our well-balanced portfolio in the entire oil and gas value chain.

With that, we would like now to take all your questions. Thank you for your attention.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Now we come to our first question for today, and we've got Fiona Maclean from Merrill Lynch.

Fiona Margaret Maclean - *BofA Merrill Lynch, Research Division - European Oil Services Analyst*

Fiona Maclean from Merrill Lynch. I have a question about the new disclosure that you have around floaters for this quarter. Can you explain to us exactly what is within that division and how we should think about it going forward in terms of being able to model it? And when I look over the last -- well, when I look over the last 3 periods, you've given us disclosure in terms of profitability. It does move around quite a lot. So any help you can give us there as well, it would be appreciated?

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

With regard to floater, basically this includes the projects that we have in the leased FPSO and in the sale FPSO business. So basically, in 2016 and in 2017, mainly Kaombo, John Creek and the 2 leased FPSO. For the future, clearly, John Creek is basically close to the conclusion. So the main activity will be relevant to the 2 leased FPSO and 2 Kaombo, then it will depend upon the commercial opportunity that the division is pursuing to understand whether or not there will be additional activities. However, starting from 2018, the division -- the floater will be included in the E&C Onshore. For the moment, this facility has been kept separately in order to allow a better understanding of the past and on the present performance.

Fiona Margaret Maclean - *BofA Merrill Lynch, Research Division - European Oil Services Analyst*

Okay. That is clear. Will you be providing in the future a separate disclosure for your new engineering division?

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

As soon as it becomes material, we will do it, probably starting from 2018.

Operator

Our next question comes from Phillip Lindsay from Crédit Suisse.

Phillip Anthony Lindsay - *Crédit Suisse AG, Research Division - Research Analyst*

Question on Kaombo. You said there's been an acceleration of costs on that project during the quarter. Is this within the provisioning that you took earlier on in the year? Or is that project now moved into a loss-making position? And can you talk about what confidence you can give the market that the execution of that project is sort of back on track and back under control? That's the first question. Second question on Duqm. You mentioned that you're participating in all 3 packages. Is your central assumption that you secure 1 out of the 3 packages?

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

Okay. Sorry. Kaombo. Obviously, let me start saying that, at present, Kaombo is at the very top of our priorities in terms of operational performance and contract execution. It's a contract which we have with one of our major client, also in terms of backlog, Total. It's in a country which is absolutely fundamental for the future of the company. However, let me say that Kaombo is basically one of the contract of our portfolio. Certainly, at the moment, the one attracting the utmost management attention. The project is at the -- in the crucial stage of evolution. We are now targeting together with our client the sail away of the first unit from Singapore to be then installed and start production. At this stage, we have suspended



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

any contractual negotiation with our client, and we are totally and fully focusing on the completion. So there are certainly impacts which are generated by this acceleration at the moment which we are bringing to the project. Overall, we consider that certainly there are additional risk. There may be a risk associated also, as we said already, to liquidate the damages, but there are -- on the other hand, there are all the upside related to the discussion which have not started at all, about change orders and claim. So at the moment, this is all suspended, and the focus is totally on deliver. So basically, that is the present status.

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

Duqm.

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

Duqm, sorry. Duqm, yes, 3 packages. We have been bidding all the 3. You are right, we are targeting 1 of the 3 packages. And I would say that the press has already provided an indication on which is going to whom.

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

If I may add one thing regarding Kaombo, because the question was also relevant to the profitability of the project. As we said last quarter, the project was in -- at breakeven, not including the cost of the withholding tax, which drains cash. Obviously, since there was an acceleration with additional cost in this quarter, this resulted in a loss. Since the project was at breakeven, whichever additional cost is recorded by the project, it means that this has to be provisioned immediately and it brings the project at loss and also has relevant impact also on the revenues because, clearly, then the advance of the project is revised and also the revenues are revised. So just to be consistent with what we said before, it's clear that if the project was at breakeven and has recorded additional cost, now the project is in loss also at the operational level before taking into consideration the withholding tax.

Phillip Anthony Lindsay - *Crédit Suisse AG, Research Division - Research Analyst*

Just one supplementary, if I could. In the past, I know you talked about having a cost structure in place that's capable of servicing approximately EUR 10 billion of revenues for the group. Clearly, today, you're taking some additional restructuring, and you're scrapping some assets and you're guiding down on full year '17 revenues. So should we assume that the new cost structure is consistent with a revenue base that is materially lower than the EUR 10 billion that you talked about in the past?

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

Look, quite frankly, yes, obviously, we've built an organization -- philosophically, we built an organization to serve a certain volume, but there is also an issue on efficiency. And I think all the actions which we -- I have been describing and which we are putting in place are not only tailored on the size or volumes which we intend to tackle but also on the efficiency of the approach we are taking. There is no doubt whatsoever that the industry has been going through a period of crazy things, I mean, both on the client and from the contracting side. On the account of the fast-track time-to-market, the efficiency is something which has been going totally outside the control of both clients and contractors. I think our clients are doing their share of the effort, and we can only do our share. So things which were philosophically contemplated are now becoming much more closer to standard approach -- more standard approach and less customized. I think this is the big bet for the industry going forward. Altogether, clients and contractor, we have to manage to the reduced, substantially, the breakeven of the -- per barrel of the development to allow the new barrels to be developed. And I would say this is very much in focus in our organization.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Operator

Next question comes from Mediobanca from Alessandro Pozzi.

Alessandro Pozzi

I have 2. The first one is on offshore drilling. You delivered some pretty good margins in Q2, and I think you explained why. Just wondering if you can give a sense of how the margins are going to evolve in the second half of the year as the new contracts come through? And also second question, kind of going to going back to what was previously asked. I think it's good to see that you reduced the workforce, but I think looking at your competitors as well, it feels like you're still oversized. I'm just wondering whether more drastic measures needs be taken over the next, say, 12 months.

Giulio Bozzini - Saipem S.p.A. - Chief Financial and Strategy Officer

So first, with regard to the offshore drilling. As I said, the offshore drilling margin were extremely resilient in the first half of this year. In the second half of this year, the idleness, which will be higher, in particular, as said, the Scarabeo 5 will be totally idle. So the margins will decline in the second half of 2017 compared to the first half of 2017. This decline will be higher in term of margins than in terms of revenues. Because in terms of revenues, the second half will benefit from the contract for the Scarabeo 9, which as we mentioned before, is lump sum contracts which basically reimburse the cost for the modification of the vessel to go to be operational in the Black Sea. So basically, these are revenues but with an extremely limited marginality associated. So basically, in terms of revenues, there will be a slight decrease. In terms of margin, the decrease will be more pronounced.

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

In terms of the second question, I heard the comment about the oversize of our organization, but that means that we are not very good in communicating because since we started the Fit for the Future original one, we have reduced 16,000 resources, out of which 5,000 are, let me say, permanent workforce. Now these 1,150 are additional resources, and these come from the -- mostly the head office -- the various head office of our company. So we are now reducing -- further reducing. We are continuing in the effort. So oversize is certainly a good starting point, mentally speaking. So you always need to consider yourself oversized, but we think that we have been operating very efficiently and effectively. And as I said clearly a number of times in presentation, that's not the end of the game. We'll continue on that path.

Alessandro Pozzi

And just wondering, what is the number of -- total number of employees that you expect to have at say, year-end?

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

What? Sorry, what is the number?

Alessandro Pozzi

Of employees, the workforce -- the employees.

Giulio Bozzini - Saipem S.p.A. - Chief Financial and Strategy Officer

We'll tell you in a minute. Okay. Let's go on, and we'll come back with the data.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Alessandro Pozzi

No, it's okay.

Operator

Next question comes from Michael Rae from Redburn.

Michael Rae - Redburn (Europe) Limited, Research Division - Research Analyst

Three questions. I'll just take them one at a time, if that's okay. So the first one is on Kaombo. Sorry to dwell on that project. But can you provide some color on the expected timing of the sail away of each of the vessels? What's the current target?

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

One by one, you ask?

Michael Rae - Redburn (Europe) Limited, Research Division - Research Analyst

Yes, if you don't mind.

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

Okay. This is very simple. Because obviously, this is the theme of the conversation, which on a daily basis we are having with our client, so I don't think we ought to disclose dates.

Michael Rae - Redburn (Europe) Limited, Research Division - Research Analyst

Okay. And then second, in terms of your ongoing reporting, should we expect floaters to be split out again in 3Q and 4Q and then included in onshore from 2018? And if that is the case, I just like to put in a request for the comparable divisional split as far back as you're willing to provide it.

Giulio Bozzini - Saipem S.p.A. - Chief Financial and Strategy Officer

Yes. We expect the floaters to be reported separately until the end of the year. Then in principle, we should include it in the E&C Onshore, whether the comparison would be possible. But in any case, we will provide all the data in order to have the comparison of the different period and quarter.

Michael Rae - Redburn (Europe) Limited, Research Division - Research Analyst

Okay, okay. That's great. And finally, just on the redundancy costs, EUR 190 million. Should that be considered a full cash cost of the business? And how much of -- of that have you already incurred? And how much is still to come?



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

The restructuring cost, which are relevant to the program that we have in Italy and France, are slightly different in terms of the regulations of the different programs and in terms of the cash disbursement. From the cost point of view, I think that this is reflected in the slide that was mentioned. From a cash point of view, the balance in 2017 and 2018 will be more or less neutral, so the cash out relevant to this plan is basically offset by the saving, and then we'll start to be positive starting from 2019.

Operator

Next question comes from...

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

If I may -- sorry, if I may interject. Mr. Pozzi from Mediobanca was asking the overall number of people at the end of the year. I would say that it will be around 36,000 units, obviously subject still to the additional measures which we may identified as part of the reorganization ongoing process.

Operator

Next question comes from Rob Pulleyn from Morgan Stanley.

Robert John Pulleyn - *Morgan Stanley, Research Division - Analyst*

May I ask 2 questions on working capital? The first one, quite simply is, how much, if any, working capital recovery do you expect in your net debt guidance for this year in terms of outstanding disputes? And maybe just give an update on where we are with both Gazprom and those Algerian revenues? And the second one and slightly a bit more complex is that in the half year and in the full year accounts, you give the split out of working capital into the construction contract assets. And I can't help but notice that the net construction contracts increased through 2016 to EUR 739 million from EUR 148 million. That's quite a move driven by construction contract liabilities, and I was just wondering why that was?

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

So with regard to the first question regarding working capital assumption, we have nothing which is stemming from the ongoing arbitrations and disputes that we have. Pending revenues is different. Pending revenues, there was also a slide that we showed in the full year results. And basically, this is something that is more or less solved in the sense that, as we said last time, we are now to a level which is very normal. With respect instead to the long-lasting disputes, Algeria, Russia, et cetera, we are assuming not cash in 2017. I didn't get exactly the point regarding the second question.

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

Can you repeat it, please?

Robert John Pulleyn - *Morgan Stanley, Research Division - Analyst*

Sure. So we don't have the first half full accounts yet. But in the full year accounts, where you split out the construction contracts, assets and liabilities, I can't help but notice that the construction contracts net balance increased substantially through 2016, and that seems to have been driven by construction contract liabilities falling around about EUR 500 million. And I was just wondering why that was. It's quite a big change versus what you normally have in a year over the last 10 years' worth of accounts we have for you guys. Maybe we can take it off-line, but...



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

I think we are not sure we quite understand. So maybe if we can take it off-line, we can certainly address your point. If I may add specifically on the ongoing arbitration as far as Russia and Algeria is concerned, as Giulio was saying, we are not expecting anything to impact the accounts. The arbitration, they are progressing according to the schedule. However, as we consistently -- with what we always said, we are more than keen to meet and find with our clients there a mutually acceptable resolution. So there are 2 parts: One is the formal one on the arbitration; and the second one is the informal one, whereby obviously we are not after making money with arbitration. We want to make money with our activities. So we are more than willing to find acceptable solution.

Robert John Pulleyn - *Morgan Stanley, Research Division - Analyst*

Okay. And sorry, I just had a follow-up on a totally different topic is that we've seen several newswires suggesting you would be involved with the second Arctic LNG project involving Novatek. Could you maybe just add a bit of color on this? And whether in that contract or potential contract, sorry, you'd be willing to take lump sum risk in Russia?

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

That's a good question. No, as far as a little bit of more color, you probably recall that we have signed an MOU with Novatek and their partners. We are currently moving on with the discussion. Obviously, the news flow is coming from the other side, and we consider it positive -- as positive that we included in our slide. The difficulties on our side is now to quantify what is the amount of -- what is the size of the impact on our work order. So at the moment, we are still discussing that. We believe that we shall have an involvement as far as the assembly of the concrete structure fabrication facility in the Yamal Peninsula, certainly not taking any position in the shareholding, but participating in terms of the expert function. We have also -- we are going also to have a participation initially in the development of the FEED for the facility. And there again, we are far away from defining whether we take or not a lump sum risk. But certainly, we are not -- we are far from being keen of taking lump sum risk in that part of the world in particular.

Operator

Our next question comes from Mick Pickup from Barclays.

Mick Pickup - *Barclays PLC, Research Division - MD*

Quick question. You mentioned Liza going traditional rather than integrated. Wondering if you can give any color as to conversations you have with your clients why they decided to go down that route? And any other projects, how you are seeing the client base evolving?

Porcari, Stefano

It's Stefano Porcari answering. The sale is always a client decision which is the contractual strategy to apply to its kind of projects. I think that Exxon decided that to go this way for different reason. One reason is, of course, because they believe and they have a very strong idea for FEED and conceptual studies. The second one is because they prefer to go in split packages and to go for, let's say, best in class for technical conversion proposal. And therefore, they are -- they made this choice in this way. I think, in our cases, we had a very strong technical proposal, and our commercial price -- commercial proposal was attractive. And we had an experience of working in frontiers countries. And we have a strong and long relationship with Exxon working in difficult environments, in new environment with technical challenges. So I think it was a natural choice.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Mick Pickup - Barclays PLC, Research Division - MD

Okay. And on the bidding pipeline and integrated versus traditional, what you're seeing?

Porcari, Stefano

Regarding vessel integration EPCI, I think that there is a good reason to select, in some cases, the integrated EPCI for SURF. Today, we are in a difficult and challenging environment, and we are trying to find the best solution to develop this new field, so we are working with our clients to have good economics. And if you -- and in many cases, you need to engage the clients at the early stage, working together for the optimization of the fields, for standardization of equipment, for simplification of all the interfaces between the various packages. And I think that, at the end of the day, it's also an interface and risk management. So there are clients, there are situation, there are projects in which this opportunity is good, but it's a choice. And in other cases, it's not a differentiator. So it depends on the clients. It depends on the projects. It depends on the moment and the timing. I think that we are bidding in both cases. We are ready to work with our partners or we are ready to work for a single package. We are bidding in both cases, with no, let's say, no -- it depends on the clients and choice at the end of the day.

Mick Pickup - Barclays PLC, Research Division - MD

Okay. A second question, if I may. You're also moving floaters into the onshore division because of the skill set involved, why you are not moving fixed facilities as well?

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

Fixed facilities? Since the -- I understand what the reason for the question. The floater, we consider floater -- the floater as a plant design and built on a floating piece of equipment. Fixed facilities is something we still consider different, much more related to the T&I type of operation, whereby we certainly do transport and installation, but we also integrate transport and installation with the building of the facilities. So I would say, it would be a long shot also to include the fixed facilities in the onshore.

Operator

Our next question comes from Amy Wong from UBS.

Hin Kin Wong - UBS Investment Bank, Research Division - Executive Director and Analyst

I just have 1 question left. It's good to see that there's still some new E&C opportunities creeping up on your slide. Can you just give us some insight into some of these initial discussions with your customers? What they're looking for? The pricing dynamic on these new projects? How they compare to similar projects that you had been bidding on, say about a year ago?

Stefano Cao - Saipem S.p.A. - CEO and Non Independent Director

Yes. I'll try to give you a little bit of flavor. You obviously refer to the overall lease of opportunities in the slide. I would say that we have always to make a big differentiation between Onshore E&C and Offshore E&C. So talking first about the Onshore E&C is noted by definition, this is an area where the competition is much higher, much more aggressive. So I think we -- our target needs to be limited to the -- those opportunities where we can still expect a reasonable outcome in terms of marginality. There is a fairly large number of opportunities, as you see, from the lease we provide ourselves. Certainly, there are certain segments where we feel to be stronger in terms of competencies, in terms of marginal capabilities. And these are related to the -- for instance, to the LNG developments, which at the moment they are still slow in the final investment decision in certain opportunities, whereby we can apply our technology in terms of fertilizer, for instance, which we then need to pursue all around the world. And then on specific situation, whereby our recognized building -- capacity in building pipelines can provide a good support to our respected



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

marginality. In terms of offshore, there will be additional phases for the subsequent phase on Zohr development, which is something which we'll never pursue, although it is not forthcoming in the near future. There is the SURF project in Nigeria, ZabaZaba, which certainly is quite an interesting target for us. There are a number of known CapEx opportunities, such as platform removal. There are also, as a complement, a number of opportunities in the renewable business in particular in the North Sea and also elsewhere. Then in terms of subsea, we look at the Mozambique development as an interesting potential opportunity, and also a number of IMR opportunities in the North Sea and elsewhere, in particular in the Caspian Sea, in Azerbaijan in particular. In terms of the expected marginality, I would say that, comparing onshore and offshore, we target and aim at higher marginality for the Offshore E&C, which goes without saying.

Hin Kin Wong - *UBS Investment Bank, Research Division - Executive Director and Analyst*

Right. Just a quick follow-up on the new projects that are cropping up in this particular slide, especially in the offshore. Happened during a quarter obviously whether your sentiment on the oil price turned quite drastically. So that it come as a surprise that you still had quite a few new offshore opportunities? Or should we expect that sentiment to reverse in the second half, you think?

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

I think that rather than the oil price, we look carefully at the CapEx program of the oil prices. There are, at the moment, very weak signs of seeing a change in the CapEx. Obviously, there will be a timing for the amounts of the oil companies. Normally, that timing is the beginning of the following year. So February, March and on, will be the time for the oil companies to disclose their CapEx program. And that will be probably a point of check to see whether there is a change in the approach.

Operator

Our next question comes from James Thompson from JPMorgan.

James Thompson - *JP Morgan Chase & Co, Research Division - Analyst*

But I just wanted to ask a couple of questions, sticking with the same slide. You talk about EUR 4 billion of orders expected in the second half on that slide. I just wondered, of those 12 projects, what the total value was? I'm really trying to understand the confidence you have in winning those awards. Is it 50%? Is that EUR 4 billion 50% of the awards on Slide 17? And then really the sort of follow-on to that is in terms of your 2018 position. You've shown us that you've got EUR 4.6 billion of awards in your backlog due for execution next year, in the context of EUR 4 billion of order intake in the second half. What confidence do you have around the -- just shy of EUR 9 billion 2018 consensus revenue forecast? Or if you don't want to give 2018 guidance, the confidence in quite a substantial volume of change orders coming through in 2018?

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

If you heard in my speaking notes, I clearly mentioned that we target EUR 4 billion out of this, but certainly, we don't expect to get all of them. The order of magnitude of all these initiatives are around \$6 billion, so it is 50% higher. This is -- just for the sake of clarity, this is opportunities with a level of maturity much higher than those released in the subsequent slide, just for the sake of clarity.

Giulio Bozzini - *Saipem S.p.A. - Chief Financial and Strategy Officer*

Okay. With respect to 2018, I think that we never gave any kind of guidance. These are contracts that should materialize. If and when they will materialize, they will be added in our backlog also for the execution in 2018. And only at that time, we'll be in a position to comment on 2018. As we previously stated, the guidance for 2018 will be given with the publication of our full year 2017 results.



JULY 25, 2017 / 7:00AM, SPM.MI - Q2 2017 Saipem SpA Earnings Call

Operator

This was the last question in queue. I would now like to hand the call back to Mr. Stefano Cao.

Stefano Cao - *Saipem S.p.A. - CEO and Non Independent Director*

Okay. I think the review we made was quite thorough. Thank you very much for your participation. Look forward to meet all of you in the near future. Thank you very much.

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