

PROSPECTS FOR INTERNATIONALISATION A CASE STUDY: THE ERG GROUP FROM OIL TO MULTI-ENERGY

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THE BEGINNINGS

The history of the ERG Group started on 2 June 1938 when the Podestà of Genoa granted the license for “trading products derived from petroleum and tar” to Edoardo Garrone, grandfather of the current Chairman Edoardo. Thus was founded Edoardo Garrone’s sole proprietorship. For the company, which became a refinery in the early post-war years, a die was chosen as a symbol (from the Italian word “Dado”, a nickname for Edoardo, which also means “die”); its faces bear a three-letter acronym. The initials of Edoardo Garrone Refinery written on the faces of the die read... ERG. After the war, in a country that had to be rebuilt from the ground up, the great demand for energy, exacerbated by the utterly devastated condition of electrical plants, found in petroleum the most suitable energy source to meet national needs thanks to its low price, availability and flexible procurement.

The first refinery began operations in Genoa in 1947 with a capacity of 0.35 kt/y.

The international scene in the ‘50s and ‘60s saw an increase in the power of the big names controlling procurement of crude and in order to maximize the advantages of the economic environment, producing countries increasingly began working together and created OPEC (1960).

The rapid growth in consumption connected to the economic boom following the war and the resulting strong demand for energy created a particularly favourable scenario for refining and the strategic development of logistics.

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Refining operations, thanks to the favourable economic environment and the excellent geographic position of plants, thus became strategic for ERG.

After consolidating its standing in Italy, in 1956 the company signed the first major international agreement with British Petroleum which, subsequently and for several years, held a significant minority stake in ERG's share capital.

In 1963, the annual processing capacity of the refinery had already reached 6.5 million tonnes and ERG expanded its logistics system to the northwest with the creation of the Arquata Scrivia depot.

THE '70S: EVOLUTION IN THE REFINING MARKET

The following years were favourable for the refining market although they were characterized by cyclical disturbances in the price of crude caused by an intermingling of energy procurement issues and economic and diplomatic interests between the countries along with geopolitical issues. The years of the oil crisis ('73-'74 and '79-'82) saw important speculations and actions by OPEC.

Within this context, the Genoa refinery, at the time obsolete, displayed the limits of its production cycle while the capacity for refining in Italy simultaneously continued to grow, decreasing the market share held by ERG.

ERG thus decided to take a leap forward in the refining sector: in 1971 ERG joined other private groups as a shareholder of ISAB, a company founded to build a large refinery in Sicily, while simultaneously preparing to shut down the Genoa refinery.

ISAB is a technically advanced and complex refinery capable of processing a difficult, inexpensive raw material and converting it into high added value products (capacity 220 kbd).

Excluding the years of the oil crisis, processing at ISAB has been maximised and guarantees margins adequate to deliver on investments.

Following the market disturbances of the '70s, the rationalisation

of the refining capacity in Italy during the early '80s strengthened the position of ISAB and ERG's market share.

THE '80s: PRODUCT SURPLUS COMPARED TO DEMAND

The '80s were characterised by a strong increase in market volatility and a product surplus compared with demand: refining margins were unstable and increasingly conditioned by geopolitical factors (decreased processing during times of crisis and product surplus compared with domestic market demand) while the tightening of fuel specifications required large investments to adequately supply a growing demand.

ERG reacted to this scenario by pushing for diversification and focusing on vertical integration with marketing (retail and wholesale).

The strong synergies achieved between marketing and refining generated various benefits:

- the domestic market guaranteed a profitable position for refined products, protecting processing even during times of crisis;
- margins became stable and anti-cyclical, generating a flow of cash that supported financial demands.

ERG maximised the positive effects of this strategy by focusing on growth in the marketing sector through important acquisitions:

- in 1895 it acquired the ELF network (about 780 sales outlets);
- in 1896 it bought out Chevron (1,700 sales outlets and shares in the Sarpom and Rome refinery).

By the end of the '80s ERG held a retail market share of 5.6% and a wholesale share of 8%.

LATE '90s – EARLY 2000s: LAUNCH IN THE ELECTRIC POWER SECTOR

The decade between the start of the '90s and the early 2000s marked a highly important step in ERG's development: its launch in the electric power sector.

The general scenario in the sector showed the refining industry under great pressure with a growth in residual demand (+ 1.6%/year from 1998-2005); the growth in dieselisation created a surplus of

gasoline and a general drop in the demand of the heavy products (fuel oil) influenced the sustainability of refineries and pushed for an increase in conversion.

ERG faced the evolution of the environment by implementing innovative solutions:

- the '90s saw the establishment of ISAB Energy (528 MW), an IGCC plant for electric power generation incentivised (CIP6) through the distribution of processing residues from the refinery: power stabilised the cash flow;
- in 2002, to improve the conversion level of the ISAB Refinery, ERG acquired the ENI refinery located in the same industrial complex as ISAB.

By building a system of pipelines the two refineries were integrated and the production cycle optimised; the total processing in the new integrated refinery complex reached 18 MTon/year and improved the conversion level through catalytic conversion (FCC) fuelled by atmospheric residues and heavy products from thermal conversion (DAO). The Nelson complexity index rose from 7.6 to 9.3.

2005-2008

In its work with ISAB Energy ERG acquired know-how and technical/operational skills in the world of electric power. The Group was prepared to tackle new horizons to broaden its business portfolio, minimizing exposure to risk and maximizing opportunities to exploit new market opportunities.

In 2004 ERG entered the renewable energy sector and, in 2006, acquired 51.33% of the share capital of Enertad S.p.A., a listed company active in the generation of electric power from renewable sources; in 2007 this stake rose to 68.38%. The acquisition of the stake in Enertad was a decisive step in the strategies pursued by the Group to expand and consolidate its position in the renewable energies sector.

In May 2008 a partial split of ERG Power & Gas enabled it to integrate into Enertad the Group's activities in the renewable energies sector; as a result of the transaction, ERG's stake in Enertad reached 77.4% of the share capital.

Following the acquisition of the ERG Power & Gas assets in the renewable energies sector, Enertad changed its name to ERG Renew, thus marking the completion of an integration and reorganisation process meant to turn ERG Renew into the ERG Group company dedicated to the development of activities in the field of energy generation from renewable sources.

In 2008 ERG Renew owned operational wind parks for 199 MW (Italy and France) with important expansion programmes abroad as well.

In the meantime, in the northern plants of the refinery, the 480 MW CCGT project was launched aimed at transforming the refinery facilities into a market-clearing plant.

RECENT YEARS: 2008-2010. OIL STRATEGY

In recent years the ERG Group has focused its growth and diversification strategy on establishing and strengthening its presence in the oil sector through synergies and agreements with international partners.

2008 was the year of the agreement with LUKOIL, one of the most important agreements in the Group's history; through the incorporation of the "Newco" ISAB Srl (51% Raffinerie Mediterranee and 49% LUKOIL), it led to a solid partnership in coastal refining operations.

The agreement, announced on 24 June 2008 and closed on 1 December 2008, entailed transferring to the Newco the business unit of ERG Raffinerie Mediterranee, which includes all the assets of the ISAB Refinery in Priolo.

This major joint venture confirms the Group's strategy, distinguished, in the past as in the present, by agreements with top tier international partners, which have always provided significant opportunities for development and growth.

Entirely consistently with a multi-energy strategy aimed at optimising invested capital among the different sectors, the transaction assured financial resources and made it possible to strengthen the group's financial structure, providing the necessary flexibility to

exploit any new development opportunities in its various areas of operation in Italy and abroad.

The partnership with LUKOIL, a leading integrated company in the petroleum and gas sector worldwide, enhanced the managerial skills in the plants with significant benefits for the competitiveness and efficiency of the refinery and it also provided potential benefits in terms of synergies and access to new markets.

Early 2010 saw the establishment of TotalErg, a joint venture resulting from the merger of ERG Petroli and Total Italia.

TotalErg (51% ERG – 49% Total), officially operating since 1 October 2010, is the third largest operator in Italy in the distribution of petroleum products with a market share of about 12% and over 3,300 service stations which became 3,400 in 2011: hence, the partnership with Total enabled both partners to achieve a significantly stronger position on the market and to share their assets and expertise.

Thanks to the high potential for managerial and operating synergies, TotalErg, in addition to expanding the services and products offered to its customers, will make it possible to attain significant economic benefits, creating value for its shareholders.

RECENT YEARS: 2008-2010. RENEWABLE STRATEGY

In 2010, the ERG Group made sizable investments (about EUR 250 million) and also focused on the renewable energies sector: through the agreement with IVPC S.a.s. ERG acquired the entire share capital of IVPC Power 5 S.r.l., owner of two wind farms with an installed power of 102 MW. Thanks to the acquisition, ERG Renew increased installed power from 208 MW to 310 MW (246 MW of which are in Italy).

Its strategy of alliances with key international players also distinguishes the renewable sector: in mid 2010 ERG and Lukoil signed a Memorandum of Understanding to share the basic prerequisites and conditions for a collaboration in the renewable energy market, in particular in the wind segment.

The agreement was targeted at the search for business opportunities, primarily in Eastern European countries and in Russia,

which display great potential for development; the collaboration supports Lukoil's strong industrial presence in those areas and encourages optimal relations between the consolidated partners in their joint management of ISAB.

LATEST DEVELOPMENTS: AN INCREASING FOCUS ON DIVERSIFICATION

Recent years, defined by a slower recovery than expected, particularly in Europe, and still depressed margins in the refining (on a global level) and power (in Europe) sectors, also show a possible "normalisation" in Italy of the Regulatory Framework for Renewable Energies.

ERG's strategy is to manage and expand a diversified "multi-energy" industrial group, whose main objective is to create lasting value by increasing profitability, maintaining a financial balance and continuously reducing its dependence on volatile exogenous factors, also through a balanced management of its portfolio.

In 2011, the ERG Group successfully completed corporate operations of particular importance for the renewable energy sector: in June it concluded the public offer (launched in December 2010) on the ordinary shares in ERG Renew and the subsequent delisting; this transaction was focused on achieving greater financial, organisational and managerial flexibility to support the achievement of investment and market positioning objectives.

The offer on ERG Renew is fully in line with ERG's broader plan – launched some time ago with the joint ventures with Lukoil and Total – which aims to optimise capital invested both directly and indirectly in the various business sectors where the Group operates, with the goal of achieving greater flexibility to continue developing energy from renewable sources.

At the beginning of 2011, ERG exercised the put option on 11% of ISAB S.r.l reducing its share in ISAB S.r.l. from 51% to 40%. The transaction enabled the Group to maintain a significant industrial role in coastal refining, thanks to no changes in governance, whilst strengthening its financial structure in compliance with our multi-energy strategy.

ERG Renew, third in the sector in Italy, continued its growth plan in 2011: over the year it completed work on the wind farm in Fossa del Lupo (97.5 MW), Ginestra (40MW) and purchased five wind farms in Campania (for a total of about 112 MW).

In November 2011 ERG and IREN, through the subsidiary IREN Mercato, signed a binding Framework Agreement for the supply of 2 TWh per year of power for 6 years to IREN, and the transfer to IREN of the ERG business unit responsible for the marketing and sale of electric power.

In view of a complex economic scenario, influenced by a persistent crisis in the refining sector, and as part of a strategy aimed at ensuring the creation of sustainable value over time, in early 2012, the Board of Directors of ERG S.p.A. approved the exercise of the put option on a share of an additional 20% of ISAB S.r.l.

Following to that operation, in the second quarter of 2012, the ISAB refinery will be owned 80% by LUKOIL and 20% by ERG, which, however, remains on the Board of Directors and managerial committees of ISAB.

The transaction, which is part of the Group's diversification strategy, in addition to decreasing exposure in the refining sector, made it possible to further strengthen the financial structure, in a time of severe crisis for the credit system, and to continue investing in more profitable sectors, renewable energy in particular.

In February 2012, LUKERG Renew, the joint venture of ERG Renew and LUKOIL Ecoenergo, has signed an agreement with Raiffeisen Energy & Environment, an entity of the Austrian Raiffeisen Bank Group, for the purchase of a 100% equity interest in a wind farm in Bulgaria, in the region of Dobrich, with an installed capacity of approximately 40 MW, operational since 2009.

This important operation, just a few months after being set up, has allowed ERG Renew to enter the Bulgarian wind market with a share of approximately 10%.

THE ERG GROUP TODAY

Following to the afore mentioned developments carried out in the previous years, ERG Group, and its subsidiaries and joint

ventures with leading international players, nowadays operates in the following segments:

Refining & Marketing

The Group is active in the coastal refining segment through the joint venture with LUKOIL, which controls the ISAB refinery in Priolo, one of the main sites in the Mediterranean both in terms of capacity (320 thousand barrels/days) and complexity (Nelson index 9.3) and in integrated downstream, through TotalErg, a joint venture with Total, with a network of about 3,400 sales outlets (about 12% market share) and fuel sales of 4 million m³/year, and through ERG Oil Sicilia (EOS), a company that received, following a split on 1 April 2010, the business unit comprising the assets of ERG Petroli S.p.A. in Sicily.

TotalErg also operates in the refining segment (the Rome refinery, wholly owned, and the Sarpom refinery in Trecate, with a 26% share).

Power & Gas

The Group is active in the production and marketing of thermoelectric energy, steam and gas. ERG's main investments in the segment are:

ISAB Energy S.r.l.: generation of electricity with a power plant (528 MW), fuelled by gas obtained from a complex process of gasification of asphalt originating from the ISAB Refinery in Priolo (Sicily);

ERG Power S.r.l.: this company owns the north plant of the Priolo site (480 MW), comprising the combined cycle plant fuelled with natural gas and the existing counter-pressure plants.

Projects under Authorization:

Ionio Gas S.r.l.: a joint venture with Shell Energy Italia for the development of a liquid natural gas regasification plant in Priolo, Sicily.

ERG Rivara Storage (15% ERG, 85% Independent Gas Management – Independent Resources Group): a company for the construction and operation of an underground natural gas storage site in Rivara in the Municipality of San Felice sul Panaro – Modena.

Renewable Energies

Through the subsidiary ERG Renew, the Group operates in the generation of electric power from renewable sources with 548 MW of installed power in the wind sector, including 158 in Puglia, 140 in Campania, 98 in Calabria, 40 in Molise, 38 in Sicily, 9 in Latium, 2 in Liguria and 64 in France.

In May 2011 ERG Renew and LUKOIL-Ecoenergo (a company established in early 2011 for the generation of hydroelectric, wind and solar power, which currently operates four hydroelectric plants for an installed power of 296.8 MW) signed an agreement for the incorporation of the joint venture LUKERG Renew, with its registered office in Vienna.

In February 2012 LUKERG Renew signed an agreement with Raiffeisen Energy & Environment, a company within the Austrian banking group Raiffeisen, for the 100% acquisition of a wind farm in the Dobrich region of Bulgaria, for an installed capacity of about 40 MW, in operation since 2009.

ERG Renew has thus entered the wind market in Bulgaria and through LUKERG Renew acquired a 40 MW wind farm equal to 10% of the market.

ERG NUMBERS (UPDATED 31/12/2011)

Retail market share**:	12.0 %
Service stations**:	3,383
Employees at period end:	652
Electric power generation:	7,4 TWh
Processing of crude in refineries ***:	10 million Tons
Net results for the group at replacement cost****:	EUR (49) million
Investments*:	EUR 156 million
Group debt:	EUR 1.179 million (late 2011)
EBITDA*:	284 million
Consolidated revenues:	EUR 6,798 million
Net invested capital:	EUR 2,842 million

- * the results at replacement cost do not include gains (losses) on inventory and non characteristic items. The figures at adjusted replacement cost take into account, for the portion pertaining to ERG (51%), the added contribution from the results of ISAB S.r.l. (company created in joint venture with LUKOIL) and TotalErg S.p.A. (company created in joint venture with TOTAL).
- ** TotalErg results, joint venture with TOTAL for the portion attributable to ERG (51%), do not include the figures regarding Sicily retail network owned by ERG Oil Sicilia (a 100% ERG controlled company).
- *** The figure does not include gains (losses) on inventory and non characteristic items and the relevant taxes. The values correspond to the adjusted ones.
- **** The results include the processing carried out by TotalERG refineries.