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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Saipem First Half 2021 Results Call. (Operator Instructions)

I would now like to hand the conference over to the CEO, Francesco Caio. Please go ahead, sir.

Francesco Caio - *Saipem SpA - CEO, GM & Director*

Good morning, and thank you all for joining us. I'm here today with our CFO, Antonio Paccioretti; and my colleague, divisional COOs, together with the IR team. Before we get into the details of the numbers in the presentation, let me say that clearly, although challenging events have impacted our numbers as you've seen. I strongly believe that none of those undermines Saipem structural strength.

In Q2, significantly, COVID affected the execution of our projects, slowing the progress, some of those whilst increasing cost. Our largest LNG project in Mozambique was suspended, and a technical issue in one specific offshore wind project had material consequences on our EBITDA. Now none of that, however, changes the fundamental strength of our company, the resilience, the width and breadth of our competencies and the wealth of well-established relationship with key clients. And it is actually on this trend that I intend to build a more competitive Saipem.

And to that end, we've launched a strategic review where we are about to put together a new plan that we intend to present in autumn in a Capital Market Day. But we've also launched a program to reduce operating leverage through streamlining of operations and processes. And for the time being, we've identified 84 initiatives that will yield, when fully implemented, about EUR 100 million in savings, and we will get back as things progress.

But as I look forward, I see 3 concrete sources of growth that Saipem is well positioned to capture. First and foremost, the new investment cycle in traditional systems and value chains, the ones that you can call our core business. And we've seen already evidence of that, very concrete evidence of that in our drilling fleet engagements, particularly in regions where, as you know, we have a well-established presence, namely the Middle East.

Secondly, we look at energy transition as a source of growth. Energy transition drives investment in new plants and new infrastructure that Saipem is already building in renewables, via biofuels, in CO2 capture. And actually, we're working on our technology portfolio to widen it through acquisitions, such as the one we've announced in May for Naval Energies in floating wind and through joint ventures also with more tech-driven companies in green hydrogen production or with a larger company like Versalis for bioethanol.

And finally, but by no means least, is our home market, Italy, where as you know, we see natural recovery and resilience plans coming to unleash a substantial wave of investment in not only sustainable energy infrastructure, but also in high-speed rails where, as you know, Saipem has a very strong track record that is effectively competing as we speak.

So with that frame of mind, with that contextual comments, I'll hand it over to Antonio that will take us through the details of our results. Thank you.

Antonio Paccioretti

Thank you, Francesco, and good morning, everyone, from me as well. Business environment in the first half was still conditioned by pandemic, which reflected on our business, causing certain project execution delays and cost overruns. Our reference market and consequently, our project acquisitions in the last 12 months, in particular in E&C Offshore, were not sufficient to cover higher and in general, fixed costs. The total effect of the pandemic in our numbers was that we are still burning direct costs, not allocating the project. In a challenging business environment in the first half, we also had specific issues. One was related to the execution challenges in a specific offshore wind project and the other being, as you can imagine, the Mozambique project suspension.

Revenues decreased by 13%, also due to unfavorable comparison with the first quarter last year, was not fully impacted yet by CapEx costs from our clients. As a result of the elements just explained, adjusted EBITDA was negative. However, we also saw some positive developments. Firstly, our commercial activity brought good awards. Order intake was EUR 4.4 billion, which led to a book-to-bill ratio of 1.4x in the first half. Of the E&C order intake was not oil -- 85% of the E&C order take was not oil. Total backlog as a result was EUR 26.6 billion. In the appendix, you will find the user slides with a list of awards of our backlog composition also shown by year of execution.

Secondly, despite weak operational performance, cash flow was under control, resulting in a net debt of EUR 1.4 billion, lower than the end of March. The third positive is that our offshore drilling fleet is almost fully under contract, showing positive signs of recovery. This is historically a leading indicator of new investment cycle in the oil and gas that can lead to improvement also for the E&C. Drilling Onshore is set to improve utilization by year-end. The main client in the Middle East has notified us that half of the suspended rigs are about to start operation again.

Moving on to financials on Slide 10. The decrease in revenues mainly came from the 2 E&C divisions, which were the main contributors to over EUR 600 million decrease year-on-year of adjusted EBITDA. In fact, E&C Offshore EBITDA decreased by EUR 444 million, with a single largest component being the offshore wind project in the North Sea. The conditional site are challenging and recently called some technical issues. In reassessing the project, we moved the expected extra cost for the remainder of the slide to the best of our current knowledge and assessment. Negotiations are ongoing with the client to move forward. Hence, we cannot share too many details.

We have concluded just a few days ago the appraisers also on the base of the expertise findings and taking into account the most recent and ongoing discussion with the client, suppliers and our subcontractors. Let me remind you that from Q4 last year, revenues related to this project are no longer producing margin, and so it will be for the residual life of the project. The E&C Offshore EBITDA decrease was also caused by the presence in the first half 2020 of the projects in completion and reducing positive contribution upon finalization, which were not substituted by similar volumes in the last 12 months. The third element is bottlenecks in fabrication at our yard in Far East caused by COVID-19, which caused logistics issues and people mobility constraints to us, to our subcontractors and suppliers, impacting some projects. The remainder of the project or the portfolio is progressing well.

On E&C Onshore, the year-on-year adjusted EBITDA decreased by EUR 134 million. In Q2, Mozambique project contribution was lower since the bulk of revenues of the project in the quarter mainly came from reimbursement of suspension and security costs. The second element also for E&C Onshore is the absence this year of high-margin projects in completion during first half 2020 and not substituted by new ones. Third element is extra cost incurred in projects in the Middle East due to the days for restrictions related to COVID-19. Lastly, we had one-off items related to a legal case with the suppliers on an ongoing project and took some provisional receivables for a total amount of EUR 55 million. The trend of adjusted EBITDA led to adjusted net loss of over EUR 600 million in the semester.

Looking below EBITDA in Slide 11. D&A decreased by EUR 64 million due to the termination of contract on a leased E&C vessel last year and 2020 impairment of offshore drilling gas. Lower financial expenses are due to the cost incurred in the first half 2020 for the bond buyback and to lower expenses this year for foreign exchange derivatives and leasing. For the full year, we expect a lower figure than 2020. Results from investments were negative by EUR 25 million due to the progress of one project. We expect this line to improve in the second half following the execution of the projects. Taxes for the period were EUR 60 million, equal strike between corporate income taxes and withholding taxes applied to gross revenues in the specific countries. The year-on-year decrease is due to the lower taxable income. We expect second half taxes to be broadly in line with the first half. On minorities, we had no contribution from projects in entities with minority partners.

Let's take a look at the special items, Slide 12. Special items in the first half were EUR 123 million, all at EBITDA level, of which EUR 36 million were direct cash costs related to COVID-19, limited to the ones not reimbursed by clients. It is important to underline that the bulk of the effect of the overall group's financials from pandemics, such extra cost delays in manufacturing and project progress are reflected on the project's results and on our adjusted EBITDA. Others for EUR 87 million is the combination of provision for redundancy for EUR 12 million and for litigation on a project already completed for EUR 75 million. For the full year, we expect COVID-19 cost close to EUR 100 million as opposed to the EUR 110 million in the full year 2020. Bear in mind that this amount can vary according to the promise of pandemic in our countries of operations.

Let's now look from Slide 13, the key operational drivers, starting with the E&C Offshore. As I mentioned before, first half last year was only partly affected by the pandemic, and this comment is [actually bad] for all the group. First half 2021 saw reduced activity in Middle East and North Africa compared to first half 2020, partially offset by higher volumes in America and Europe. I have already explained the drivers of the negative adjusted EBITDA, but let me emphasize that the rest of the portfolio is progressing well. However, our operating leverage, this level -- with our operating leverage, this level of revenues falls short of COVID fixed costs. As our CEO said, we are working to improve this.

Moving to E&C Onshore. Revenues increased in the first half by around 4% year-on-year, driven by Sub-Saharan Africa, while Middle East recorded a decrease. Mozambique project in the first half recognized securities suspension costs on a reimbursable basis. For both E&C relation, there are conditions in place to improve the operating performance in the second half, even though in the highly uncertain pandemic context, which is at different stages in the different countries. In particular, E&Cs should benefit from the contribution of recent awards in Qatar and Saudi Arabia.

In Slide 14, we share a few thoughts on Offshore Wind and on Mozambique. We are challenged by soil condition in a specific project, which also resulted in some technical issue. Discussions are ongoing with the client to move forward. Other offshore wind projects in the portfolio are not entirely technical methodologies like the North Sea project and do not pose similar challenges. We are investing in the floating wind market with proprietary technology, recently strengthened with the acquisition of the technology from Naval Energies.

In a nutshell, offshore wind remains an attractive opportunity for us. On the Mozambique Area 1 project, we are discussing the best way forward to preserve the value of the project, assessing the security risk at site, aiming at resuming the activities smoothly after operational suspension. Timing of restock is still uncertain and will be driven by clients' programs. Residual backlog of this project at the end of June is around EUR 3.6 billion, and this figure excludes potential contribution coming from future suspension costs reimbursement, which could increase the overall revenue profile of the project for its entire life. In the second half, revenues contribution of Mozambique should come from the suspension costs on a reimbursable basis.

Let's now move to the Drilling Offshore on Slide 15 with the fleet engagement. All vessels are under contract and the commercial activity is showing signs of recovery. Our vessels utilization is ahead of the market for both shallow and deepwater. As you know, the drilling fleet has been further renewed and strengthened with the asset-light approach, which is now covering 1/3 of the vessels. We have recently added to the fleet the Santorini drillship under lease for 2 years with purchase option at Saipem's discretion and already contracted Eni for the Gulf of Mexico from November, starting drilling operation in early 2022. Santorini is a state-of-art seventh-generation drillship, further enhancing the quality of our offer. With our asset-light approach, we will play the expected cyclical recovery.

Looking at Saipem 12000 options for the further activity in Mozambique beyond October has not been exercised, and we are actively marketing the vessel. We are confident that opportunities in the East African region could materialize soon. All in all, you can see from the light blue bars in the chart that we have successfully added new work for our deepwater vessels Scarabeo 9, 8 and 5. The shallow water jack-up fleet is almost fully committed as well for the next 2 years, with only one exception, the elder unit, Perro Negro 4.

Moving now to the drilling results in Slide 16, starting with the offshore. Revenue decreased in the first half by 10% year-on-year, better than previously expected, with Q2 significantly improving mainly due to Saipem 12000. In the first half, volumes decreased year-on-year for Saipem 10000 and Perro Negro 8, partially offset by Scarabeo 8. Some vessels recovered rates, while others had rates at lower levels as a long tail of the crisis. The EBITDA decrease is due to the operating leverage. EBITDA of the division in the second half of 2021 will be affected by maintenance activity, but the recent signals we have seen in the market, which have increased our contractual engagements, give us a very good visibility for 2022.

Moving on to Drilling Offshore (sic) [Drilling Onshore]. Revenues decreased due to the lower activity in the Middle East, partly compensated by a year-on-year increase of volumes in LatAm. Adjusted EBITDA margin stayed in line with the first quarter at around 19%. Commercial outlook shows some positive signals of starting recovery, especially Middle East, where we expanded to reach contracts for additional 5 and 10 years. From the second half, half of the suspended rigs are expected to gradually restart operation. In fact, we received notice of restart from 6 of them in the Middle East.

First rig will be active during the third quarter, and this should support a gradual improvement of results with a Q4 stronger than Q3. At year-end, utilization rates of the overall fleet are expected to be at around 50% on 66 rigs, excluding Venezuela. More details on the current utilization are in the appendix. To wrap up on drilling, signals of recovery out there with fleet engagement on the rise, the positive commercial developments in Drilling Offshore are expected to bring results improvements from 2022. As contrary, Drilling Onshore is recovered as we speak in the second half this year. For the second half, we expect EBITDA adjusted for both divisions combined similar to the first half.

Let's look at the evolution of our cash flow and net debt in Slide 17. The cash flow evolution is highlighted in the light blue shaded area. Despite the weak operational performance and some cash special item related to COVID-19 cost, net cash flow from operation was neutral, thanks to the positive delta working capital, supporting by the receipt of advanced payment on the projects that are now up and running and indeed, the strict control of our cash flows. Few words on CapEx, which were EUR 140 million in the first half. These are mostly related to vessels, ordinary maintenance ahead of upcoming engagements. At the end of June, we closed with EUR 1.1 billion net debt pre IFRS 16 or EUR 1.4 billion post IFRS 16. This is lower than the end of March, which was at EUR 1.45 billion.

Slide 18 shows the liquidity and the structure. I guess we are quite familiar with this one. On the right end of the slide, you can see the debt maturity profile was spread in banners with the first significant maturity in 2022. As you know, in March this year, we issued a new EUR 500 million euro bond due to 2028, which provided a prefunding of the repayment due in 2022. Group gross debt is therefore now around EUR 3.4 billion, with tenor above 3 years and an average cash cost of around 3%. Liquidity is always very strong and EUR 3.3 billion in total, including funds available in the consolidated perimeter, cash in the joint ventures and the fully undrawn FCF of EUR 1 billion.

Turning to Slide 20. Even if today, we do not expect issues like the ones that affected the specific projects in the first half. As we commented earlier, the scenario is still complex due to the pandemic, which is particularly severe in some of the countries where we operate. Anyway, we want to provide some indication on how we see the immediate future, the second half of this year, while we progress in our strategic plan exercise, which we intend to present in autumn. In the second semester, we expect revenues between EUR 4.5 billion and EUR 5 billion. Expected fleet class renewables and project progress should lead to CapEx between EUR 200 million and EUR 300 million.

Business recovery should allow us to be back to a positive adjusted EBITDA in the second half. We expect an increase on net debt in Q3 versus Q2, driven by the progress of the projects. Then followed by decreases in quarter 4 -- in the last quarter, supported by a positive working capital dynamic with a strict control of cash flows and strong focus on collection on receivables. As a result, we expect net debt post IFRS 16 at the end of this year of around EUR 1.6 billion. This outlook does not factor further and possible material macro and business deterioration, including the evolution of the pandemic.

With this, I will hand the floor back to Francesco.

Francesco Caio - *Saipem SpA - CEO, GM & Director*

Thank you, Antonio. With that, we have completed our review of Q2 numbers. And obviously, myself, my colleagues and Antonio, we are ready to answer your questions. We're moving forward to pursue the concrete growth opportunity for which we believe Saipem is very well positioned. We'll get back to the market and open to present our new strategic plan and provide you with an update on the other programs we've launched.

I now thank everybody for your patient attention, and can we now start the Q&A session?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question came from the line Alessandro Pozzi from Mediobanca.

Alessandro Pozzi - *Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst*

I have a few questions. But first of all, I would like to congratulate Francesco and Antonio for the new positions. Maybe just wish you more under better circumstances, but here we are. So the -- I think the size of the losses is staggering this quarter. And I think it's even more staggering, given that we were expecting a gradual recovery in the Offshore E&C as per last update. So I was wondering what has really changed since then? I mean we knew COVID would have been a lingering issues, but are you upfronting some of the costs that you're expecting in the coming quarters? And maybe can you give us a split of how much costs you have embedded in the adjusted EBITDA for COVID versus the project in the offshore in the North Sea, the renewable project in the North Sea. And again, on that project, again, that has been an issue for a few quarters. Are you seeing extra cost on top of what you were expecting in Q1? That's my kind of first question at the moment.

Francesco Caio - *Saipem SpA - CEO, GM & Director*

The answer is, yes. First of all, we do have some special technical problems occurred for the project in the North Sea, and we had to recognize at the end of June, the future cost that today we are in the position to evaluate in the range of EUR 200 million, firstly. Secondly, we do have some projects jeopardized by the problems of COVID that we had in particular in the yard we had in the Far East, affecting a few projects, problems that we couldn't evaluate before. The fabrication we are talking about also started in the -- at the end of the first quarter. Thirdly, as far as the other costs for the COVID, we recognized around EUR 37 million in the first half. The expectation we have is to have such a cost close to EUR 100 million at the end of this year.

As far as the other, the last important element, there are some important element of these accounts at the end of June, which is Mozambique. Mozambique in the period represented for us in terms of revenues, a reimbursement of cost. Therefore, the contribution to the EBITDA was very, very manageable.

Alessandro Pozzi - *Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst*

Okay. And of course, with such a depressed EBITDA, I think the money goes to the covenants. So do you expect covenants to be renegotiated? Are you in talks with banks to do that for 2021? And also remaining on the net debt, I think the net debt was a positive kind of surprise, even more positive given the size of the EBITDA loss. So that's not having a cash impact at the moment, but I was wondering, at some point, it will have a cash impact on the net debt. And can you quantify when this is going to be? Are we talking about the next few quarters? Or is it going to be more in 2022, 2023?

Antonio Paccioretti

The best expectation is that the cash effect will occur during the execution of the project. So we are talking about in the following years, execution of the project, whose timing is under discussion with the client. As far as the covenant, yes. As you know, we do have some financial covenants. In particular, we do have covenants in terms of net debt-to-EBITDA in -- with a treasure of 3.5x. First of all, let me say that the covenant is calculated post-IFRS 16 reported figures with some minor adjustments on EBITDA. And most important, the ratio is tested annually at the year-end. Having said that, as described earlier, we do have a significant financial flexibility at around EUR 3.3 billion in total, if we also include, if we also consider the fully undrawn RCF for EUR 1 billion. So I would say, frankly speaking that leverage on this financial buffer, we are in the position to start a constructive discussion with our lenders soon.

Alessandro Pozzi - *Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst*

Okay. And the undrawn -- can you draw the facility even if you have a breach in the covenant? So all the funds are committed and available in the event of a breach?

Antonio Paccioretti

Today, we are not in breach. The covenant will be calculated at the end of the year.

Operator

We have the next question from the line of Sasikanth Chilukuru from Morgan Stanley.

Sasikanth Chilukuru - *Morgan Stanley, Research Division - Research Associate*

I had two, please, related to the Mozambique LNG project. The first one was, yesterday, TotalEnergies kind of highlighted a delay of at least 1 year for the resumption of activities in that specific project. Just wondering, you mentioned having discussions with the operator, but is that a view that you share that it goes beyond the end of this year for the activity to start? If you can give us any guidance on the expected timeline for resumption there.

The second one was also regarded to that project. If you could provide some more color on the steps that you have taken to actually neutralize the impact -- the cash flow impact for Mozambique LNG force majeure. If you can please let us know if these actions that you have taken for 2021, are they likely to have any negative impact on the cash flow for 2022 once the project starts?

Massimiliano Cominelli

It's Max here. Line was pretty bad. So let me ask you whether we got the right questions from you. So the first one was an update on the Mozambique project. And the second one, whether this Mozambique project, we expect any material impact in terms of cash beyond 2021. Is that correct?

Sasikanth Chilukuru - *Morgan Stanley, Research Division - Research Associate*

That's correct, yes. The first one was mostly TotalEnergies' comment saying there is a 1-year delay in resumption. So I just wanted to comment based on that.

Massimiliano Cominelli

There are delay that a client has shared publicly. And the second one is, if you expect any cash component or cash impact beyond '21 .

Maurizio Coratella - *Saipem SpA - COO of the On-shore Engineering & Construction Division*

Okay. This is Maurizio, the Head of E&C Offshore. What I can tell you is that, Total has always anticipated to us that the suspension would have lasted a minimum of 12 months, and the suspension has started in the mid of April 2021. Therefore, all our numbers are reflecting an assumption of activities in the first quarter of 2022. As far as the conversation with Total is concerned, of course, we are working together. We have a joint team reviewing constantly what are the cost of this suspension. The arrangement we are discussing and we almost finalized is for reimbursement of the cost that will incur during that period. The situation on the ground, I will not comment as the -- Total has responsibility for the security on site.

In terms of numbers, of course, we are working on estimates. We are estimating what could be the cost of the suspension, which is expansion of the duration and the agreement we will have with each and every suppliers, subcontractors in preserving the project value and suspending the activity without losing the value for the entire project. Once the project will resume, it will start with its normal progress and will contribute to the EBITDA and the margin as expected. We don't have other information to share. Thank you.

Operator

The next question is from the line of Nik Konstantakis from Exane.

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

Francesco, Antonio, welcome on board. Wish we're talking under a more positive climate. I would like to start with the balance sheet actually and just follow up on the previous question. Can you -- the release speaks to intervention actions with the lenders. Is that just a renegotiation? Or are you considering other measures? And given the pretty significant maturity in 2022 on the bond side, are you thinking about rolling it over this year? Or is that a next year event?

Then I just wanted to confirm, you talked about Mozambique just now. So for the 3 quarters that you assume in the backlog for next year, is the revenue the same as you have guided before for the 3 quarters of '21, i.e., the EUR 1.4 billion? Or is that a different figure? Lastly on litigation, can you just give us a bit more on what that relates to? Is there a potential loss there? Is there a provision that we should be thinking? And lastly, and I'm sorry for taking too many questions. We understand it's a difficult period. Everybody is facing issues with COVID but we have been in it for 18 months. So how can we -- how much of a confidence do you have on the rest of the portfolio on the actions that you're taking? I guess we'll go with this is, why is that not going to happen again in 2 or 3 quarters' time. What are the safeguards? Just any color on that on safeguard would be very helpful.

Massimiliano Cominelli

Nik, it's Max here. Sorry, but the line was not very good. Let me wrap up on the 4 questions here you asked. So the first one was on lender -- negotiations with lenders, how are you going to approach them. The second one was, what do you expect from the Mozambique in the next few quarters since you had EUR 1.4 billion to be executed pre force majeure, right?

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

No, it's for the 2022. Can we take the EUR 1.4 billion until '22? Is that what you assume in the backlog?

Massimiliano Cominelli

Okay. Backlog to be executed in 2022 on E&C Onshore. Is that -- yes?

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

I'm sorry, the...

Massimiliano Cominelli

Mozambique.

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

Exactly. Yes.

Massimiliano Cominelli

Okay. And the third one was about the provision. I couldn't get it. Can you please repeat?

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

Can you give us a bit more visibility on the litigation costs? What have we referred to? Is there a provision related to that potential loss here and the damages there? And the last one is safeguard against this happening again. COVID is uncertain, but how are you trying to protect the business in the coming quarters?

Massimiliano Cominelli

Okay. Thank you. Thank you. So let's start with the first one, perhaps, on the negotiation with lenders. How are you going to approach it?

Antonio Paccioretti

More than negotiation I will talk about conversation. I mean we do have to explain them. The reason of the financial, we have accounted. As I tried to explain before, most of the negative effect coming from the -- for the EBITDA is due to some provisions or no cash items. So I believe, again, that leveraging firstly on the liquidity we do have. Secondly, on the fact that the net financial position has been managed flat. So we do have some very good results on that and also on the perspective of the company because this is the most important one. We will have all the elements for finding with the lenders an appropriate solution.

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

Does your liquidity preclude an equity raise? Or is that amount of resolutions being considered?

Antonio Paccioretti

No. The answer is, no. Absolutely. We do not need any equity need on that. I have to apologize, but the line is very, very bad. So we are trying to understand properly the question. So which is the next one?

Massimiliano Cominelli

So the next one was on the Mozambique contribution to the backlog, what do you expect from that?

Antonio Paccioretti

As we already said, the contribution is EUR 3.6 billion. So no news about that.

Francesco Caio - *Saipem SpA - CEO, GM & Director*

This is Francesco. I think it might be helpful to repeat that the way we're dealing with Mozambique is a suspension, therefore, what we have an impact on the marginality of the work for this year. We expect the project to unfolded progress as per plan as soon the work to resume as we're hearing in negotiation with our clients, and as Maurizio mentioned before.

Nikolaos Konstantakis - *Exane BNP Paribas, Research Division - Analyst of Oil and Gas*

I'm sorry, guys. The question was on 2022, what is the assumed contribution from Mozambique for the 3 quarters? You're saying it restarts in 1Q '22 if you are assuming for the rest of the quarters, please.

Antonio Paccioretti

I mean the contribution depends on the progress. It depends on when the project will start and the progress of the project. As already discussed, we had to share with the client such a program. So we are not in a position today to share any estimation on that. For the first part, I mean, for the recognition of revenues coming from Mozambique this semester, I just want to reiterate that in the second quarter, we recognized around EUR 400 million of revenues fully related to the suspension in security cost with a return, so paid recognized on a reimbursement basis. So the margin related to this EUR 400 million was close to -- was very limited, but it is -- this is not the core of the project. The project has been suspended and will be postponed and all the targets we have on the project remain the same. As far as the litigation and the provision, we accounted for the litigation, one of them is related to a project we had which was completed, I would say, in 2015 or '16, something like that, a very good one and very long litigation.

On the provision -- on the political provision, we do have a very strict procedure for assessing the effect that we have to recognize on our balance sheet, which is based on the evolution of the litigation, and it is based on the opinion we received from lawyers -- technical lawyers for the merchant technical for the amount to be recognized. According to the most recent developments of the litigation, on the basis of the opinions we have received, we had to recognize an additional EUR 75 million of provision. And this is the one we have treated a special item. We do have also a provision in the adjusted accounts related to 2 projects coming from the same assessment supported by the external opinions from legal and engineers. That's all I can say about that. It is clear that we do not expect anything more because otherwise, we would have recognized such new item in our cost.

If I understand well about -- the last question is related to the quality of the portfolio, the quality of the rest of the portfolio. If it remains the same, we expected -- yes. The answer is, yes. Again, we had experienced one problem in a specific project in the North Sea. We do have some effect -- negative effect due to the COVID-19 for the publication in particular. For the rest, the quality of the portfolio remains absolutely in line with our expectation.

Operator

Next question is from the line of (inaudible).

Unidentified Analyst

Yes. The question, it will be mostly related to the E&C Offshore. In your prepared remarks, you say that basically your top line did not cover your fixed cost base. I was wondering if you can give us a bit of information on your fixed cost base, especially. So if you can give us the, let's say, revenue level that you need to be at breakeven because this quarter, you had the impact of this famous offshore wind project, MMG. And on MMG, I was wondering if you can -- the project has weighted on the marginality over the past 3 quarters. So I was wondering if you can give us a bit of details on how much in total you booked in terms of over cost in this project because it was a relatively major one for you, several hundred millions euro. So if you can give us now the magnitude of the loss that you booked in Q4, in Q1 and in Q2 now, please?

Antonio Paccioretti

The second question is easier. The additional costs that we had to recognize, as I said before, in the range of EUR 200 million. As far as the operative leverage, let me say, this is one of the element that we have to assess and would be also part of our exercise on for the next strategy update. Let's add a few weeks for assessing better this problem, and we will talk about that next autumn. But you are right, this is one of the issue.

Unidentified Analyst

But can you just provide the Q2? If we're talking about expecting breakeven moment for Q3, Q4, et cetera, can you give us the Q2 level that you would have moved to be at breakeven, excluding MMG?

Antonio Paccioretti

Sorry, we are trying to elaborate an answer. Give us a few seconds. Sorry, anyway, I would -- anyway, I would prefer to elaborate better on that next, next autumn. But let me give you a straight answer, which is the following: the results of the Offshore division is negative for an amount which is some higher than EUR 200 million, EUR 270 million. And it is affected by the nonrecurring item of EUR 200 million for the North Sea project. So I would say that without this project, the EBITDA would be around EUR 0. So the amount of cost that we would recover with additional revenues for covering the operating leverage is around EUR 200 million. Anyway, just for...

Francesco Caio - *Saipem SpA - CEO, GM & Director*

And to complete the picture, and your question was very clear, indeed. Obviously, you've seen the volumes in first half of the Offshore division being particularly low. We expect that situation already to begin to improve in second half, thanks to the acquisitions we've announced in last few months.

Operator

The next question came from the line of Mark Wilson from Jefferies.

Mark Wilson - *Jefferies LLC, Research Division - Oil and Gas Equity Analyst*

I just want to clarify one point in terms of the improvement in the second half. You point to the new awards in Saudi and Qatar as being one of the reasons that E&C will improve in the second half. But at the same time, you speak to extension of projects in the Middle East as a consequence of COVID being one of the impacts on the margin in the first half. So could you just speak to that and quite why the Middle East won't continue to see COVID impacts through Q3? That's the first question.

And the second point, you're obviously focusing quite a lot on the drilling and the offshore drilling with the addition of the rig. I know it's 50% of the offshore rigs are working with Eni. Could you talk to the pricing environment now for those deepwater rigs? Do you -- have we reached a trough in terms of pricing and other incrementally higher day rates coming through?

Francesco Caio - *Saipem SpA - CEO, GM & Director*

Thank you very much for your question. I think when it comes to projecting the impact of COVID-19 in those regions in various work, unfortunately, we're still short of magic balls and crystal balls to see it. However, on a more serious note, you have to consider that some of the work that will get started is in yard which is an area that is more affected by COVID than ships and vessels where we have more flexibility. And therefore, this is one also of the reasons of our prudence in talking about second half because you're right. You're absolutely right. The level of uncertainty remains high, but the diversified nature of the works that we're about to start give us some confidence about a gradual improvement in the second half. We'll see when that comes to pass.

When it comes to the drilling offshore rates and we're seeing the bottom, there are indications that we may well have seen the bottom of the rate. It's maybe a bit too early to talk about rebounds and the strong tension in the prices, but as you know, this market is very prompt in dealing in the relationship between supply and demand. There is clearly more demand than on the supply side, you begin to see some benefits.

Mark Wilson - *Jefferies LLC, Research Division - Oil and Gas Equity Analyst*

Okay. And then just to confirm on that covenant point. You say that is tested annually and you've guided to EUR 1.6 billion. So we can simply divide that by 3.5, that is the level you would have to deliver of EBITDA in 2022? Does the EUR 200 million you've spoken to in the North Sea, does that adjust down?

Massimiliano Cominelli

Just have to repeat the 2 questions. The first one is how you calculate the covenant, right? And the second one was, do you foresee other extra costs other than the EUR 200 million you had in Q2 for the North Sea. Is that correct?

Mark Wilson - *Jefferies LLC, Research Division - Oil and Gas Equity Analyst*

Yes, that is correct. That's...

Massimiliano Cominelli

Okay. So...

Antonio Paccioretti

I have to apologize, but the line is really very bad, so we had to get sometimes the question. So sorry for asking you to repeat or for permitting us, following us to repeat your question. So the first answer is clear. I mean I tried to explain before, but I confirm that the calculation is at the end of the year. Anyway, we will -- the calculation of the financial ratio, we will contact immediately our lenders in order to discuss the most appropriate way for facing this issue. The second question is for the provision we accounted for the North Sea offshore project. And I have to repeat that this is the result of our best evaluation to the information we do have today. We are not in a position to expect something more on that.

Operator

The next question came from the line of Vlad Sergievskii from Bank of America.

Vladimir Maximovich Sergievskii - *BofA Securities, Research Division - Research Analyst*

I will start with the project portfolio. Have you managed to complete the full project review by now? And would you be able to share with us what proportion of backlog is now impaired and in the future, will be running at 0 margin? This is a tough question. Hello? Can you hear me okay?

Massimiliano Cominelli

Yes, we heard you. So you're asking on the backlog, right, Vlad? And how much of that backlog has been impaired, namely related to the North Sea projects and...

Vladimir Maximovich Sergievskii - *BofA Securities, Research Division - Research Analyst*

Exactly. Exactly. This is the question. And also have you completed the full project review of the full portfolio?

Antonio Paccioretti

Yes, I try to repeat. The project review is executed regularly every month. What occurred for this project is a triggering event which posed the necessity of a reassessment -- a significant reassessment. And the result of the reassessment is the amount we have recognized in the current financials.

Vladimir Maximovich Sergievskii - *BofA Securities, Research Division - Research Analyst*

All right. That's clear. Can I ask you a question about the upcoming strategic review? Obviously, you are talking about the review of the footprint and operating leverage, which I think is definitely the right thing to do. But do you have the right balance sheet in order to do it? Obviously, you are guiding for negative free cash flow in the second half, then provisions will cash out later on. Are you able at this stage to completely rule out the need for equity at some stage in the near term?

Francesco Caio - *Saipem SpA - CEO, GM & Director*

Look, I think the strategic review is part of selecting within our portfolio of regions of clients of technologies where we want to leverage our strength to go forward and capture profitable sustainable growth. We have, as I mentioned, various streams of works focused on at least 3 fronts. Our core business, but maybe more than others, your thinking applies in terms of what is the right mix of geographic presence, account relationship and technology focus. But we also have the initiative that we are pursuing, and we will continue to pursue in any transition and potentially, hopefully, a stronger presence in our home market, Italy.

So we think we have all the flexibility we need to go forward and look forward with some confidence about the ability to make the company even more competitive. And I will leave it at that, saying that our commitment to get back to you in the autumn is an indication that we are aware that the market as we did by ourselves, have questions about priorities and way forward. We want to fully adjust them and continue to work in lines to create values for our stakeholders and shareholders in particular.

Vladimir Maximovich Sergievskii - *BofA Securities, Research Division - Research Analyst*

This is great. And a very last quick question from me, if I may. On Offshore Drilling business, do you plan to continue this pretty unusual practice of leasing someone else's rigs and using them? I mean this theme obviously helps EBITDA as, of course, you capitalize maintenance costs and lease payments are all falling below EBITDA line. But probably, it's not very cash flow accretive. If you will be able to comment on that, that would be helpful.

Massimiliano Cominelli

Vlad, your question -- sorry, it's Max here. Is it about the Drilling Offshore? We got the asset-light approach with few vessels in the portfolio. Your question was, are you going to continue on this part of leasing vessels. Is that correct, right?

Vladimir Maximovich Sergievskii - *BofA Securities, Research Division - Research Analyst*

Yes, it is correct. It's also how cash flow accretive is it, the asset-light approach?

Marco Toninelli - *Saipem SpA - COO of the Off-shore Drilling and On-shore Drilling Divisions*

Well, let me elaborate a little bit on the asset-light strategy. As I said in the previous calls, asset-light strategy is really a tactic to be able to capture the upside of the market in an environment where capital is critical and the situation. So we were able to bring 4 rigs over the last couple of years and add it to our free. So we have 1/3 of the fleet with this strategy, which generate, of course, EBITDA and contribute positively to the margin of the division. And as we -- especially with the last addition of Santorini, we count on considerably and substantially improve our operational capabilities in a very critical region and that will have a very positive effect in 2022. Of course, it depends on the market on the availability of these rigs to be rented. And unfortunately or fortunately, the market is going to pick up and therefore, it will be even more difficult to capture more opportunities. But we are ready to do so, and we're very confident that this strategy was a good choice.

Operator

The next question is from the line of Michael Alsford with Citigroup.

Michael James Alsford - *Citigroup Inc., Research Division - Director*

I've just got one question remaining. I appreciate there's a full strategic review coming up in autumn, but could you just confirm whether you're still exploring alternative options for the drilling businesses and that they remain noncore to Saipem over the medium term?

Francesco Caio - *Saipem SpA - CEO, GM & Director*

Thank you for your question. As I was mentioning before, we had to create value. And one of the tools to create value is to have a good business plan and capacity to execute it as well as some M&A levers. And I think on that last point, it's better to talk about these things when you do them rather than when you think about them. Thank you very much.

Operator

I will now hand back the conference to the CEO. Please go ahead, sir.

Francesco Caio - *Saipem SpA - CEO, GM & Director*

Thank you again for your attention, and I look forward to seeing you with my team in autumn for the new strategic plan of Saipem. Thank you again.

Operator

This concludes the conference for today. Thank you for participating. You may all disconnect.
