

ERG S.p.A.
“First Quarter 2017 Results”
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MODERATORS:
LUCA BETTONTE, GROUP CEO
PAOLO MERLI, GROUP CFO

Operator:

Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the ERG First Quarter 2017 Results Conference Call. After the presentation, there will be an opportunity to ask questions. At this time, I would like to turn the conference over to Mr. Luca Bettonte, CEO of ERG. Please go ahead Sir.

Luca Bettonte:

Good morning and thanks for coming to this conference call related to our First Quarter 2017 results. Here with me there is the CFO, Paolo Merli.

We start as usual by underlining our key figures for the quarter, as per **slide no. 4**: I dare to say good results, with growing earnings and significant deleverage. Ebitda came in at €151mn vs €163mn of the first quarter last year: lower than 2016 - as expected - although with a different outcome than expected.

First of all, Non-Programmable, so wind farms: Ebitda went down to €104mn, mainly because of lower production both in Italy and abroad (in particular in France), while the price scenario was overall better, excluding in this case the value of the Certificates of Origin in Poland. In order to understand the figure, it is worth mentioning:

- a) the impact of the phase-out of some megawatts from the incentive mechanism, and
- b) that 2017 result has benefitted from the recovery of the incentive associated to the loss of production of the previous years, due to some limitations imposed by the TSO: lower production of the wind farms, that are phasing out from the incentive mechanism during this year.

On the contrary, Programmable Ebitda was slightly higher (up from €48mn to €50mn), with different trends:

- a) positive for Hydro power, that posted very strong results, as the production was in line with 1Q 2016, but in a quite better price scenario. To be mentioned the positive contribution related to the recognition in 2017 of some Green Certificates of the previous years of about €8mn
- b) negative for Thermal power, that posted lower results as in the 1Q 2016 there were some €18mn revenues from the Essential Unit Regime, that ended in May 2016. This effect has been partly offset by higher Spark Spread, and by higher value of the so-called White Certificates (TEE).

Moving on to Net Profit, 1Q 2017 result was a bit higher than last year, and it came in at €61mn vs €57mn last year; it would be in line with 2016 if we added back to the net profit of the last year the associated value of the minority interests. This important result was achieved thanks to:

- lower financial charges, as a result of both lower average gross indebtedness and interest rates, and lower spreads, as a result of the debt optimization done last year
- higher contribution from the better performance of TotalERG, whose net result is accounted for with the equity method, and
- lower taxation thanks to lower Corporate Income Tax (down from 27% to 24%), and to the tax allowances from the application of the ACE regulation. This regulation has

been recently submitted to a downward revision for both the rates and the reference capital contribution, with immediate impact on 2017 figures.

Looking in the end at the Net Financial Position, it decreased by some €93mn (corresponding to about 61% of the Ebitda), witnessing the continuous strong deleverage, stemming from the operating cash flow of the Group.

Now I will hand you over to Paolo for his analysis.

Paolo Merli:

Thanks Luca, and good morning everybody. I will start as usual with a brief overview of the power scenario in the first quarter, as per **page no. 6**: let us start by commenting on Power Demand in Italy, the bottom left graph of the chart.

National Electricity Demand in Italy was slightly up (0.6% YoY) in 1Q 2017. Wind contribution to demand was down by 9%, Hydro -5% and Thermo up 11%. Notwithstanding the almost flat trend in Demand, National Production was up 6% to compensate for lower imports (-25% in the period) following the disruptions at some nuclear plants in France. The shortfall from France, coupled with lower Wind and Hydro productions, contributed to a significant increase in prices during the quarter, as I will discuss in a moment. In this backdrop our Wind productions in Italy were down 15% YoY, basically due to our asset location across regions with overexposure, versus the national average, to Campania and Calabria regions as well as in the two main islands (Sicily and Sardinia), where wind was weaker than in other areas of the country, such as the Adriatic coast. Hydro production was flat, thus better than Industry data. Our Thermal production was down 14% YoY, as a result of the different regulatory and competitive landscape, with 1Q 2016 still under the Essential Unit Regime.

Talking about prices, the PUN, i.e. the Average National Price in Italy was 58€/MWh in 1Q 2017, +45% year-on-year. So as explained, the recovery in prices experienced in the quarter - both in Italy and in central Europe - was mainly related to the disruptions at nuclear plants in France. Price indicator for Renewables in Italy, including Feed-in-premium, was 165€/MWh, so +18% YoY. Exceptionally in Sicily price traded at a discount vs. the National Average Price, following the exceptionally high prices in the north of the country, as a consequence of the already mentioned problems in France. The Central North Peak price (which is a sort of reference price for our Hydro operations) came in at 68€/MWh, some 10€/MWh premium compared to the National Average Price.

Generation margins were quite satisfactory in the quarter, up significantly YoY, mainly for the same reasons as regards the general situation in France. To better understand the performance of our CCGT over the period, on top of the better spark spreads, and on top of the Essential Unit Regime phase-out, I should also remind you that our gas-fired plant is classified as Highly Cogenerative. As such, it generates White Certificates whose prices went up considerably, at more than double last year's levels. So White Certificates represent a quite important stream of revenues for this plant.

Abroad, in light of our exposure to Feed-in-Tariff systems in France, Germany and Bulgaria the impact from the price scenario was practically zero - as shown in the chart - with the exception of Poland, where the general environment remains very challenging, with sale prices - including the OC - down significantly YoY, following the unfavorable regulatory framework.

Let us see Economics in a nutshell. I am on **page no. 7**. EBITDA in 1Q 2017 was €151mn - down about 7% YoY - mainly driven by the lower contribution of Wind and of the CCGT, following the exit from the Essential Unit Regime. Those effects were partly offset by better Hydro (which benefited fully from the stronger price scenario, in particular in the Central-Northern area), as well as by the recognition of incentives for a further 50MW on the entire plant, but I will comment in details later on.

I think it is important to say that our Ebitda also includes the economic effects – unfortunately negative this quarter - deriving from hedging activities on electricity prices against part of our Renewables productions, Wind and Hydro. So given the very high prices registered over the period, the realized value associated to those hedging activities was negative for about €8mn, and accounted on Wind and Hydro segments proportionally with their productions. Excluding that item - if you prefer to see it the other way round – 1Q 2017 results would have been almost in line with last year, notwithstanding the much lower volumes in Wind and the exit from the Essential Unit Regime for the CCGT. That is why we consider this set of results as very solid and satisfactory.

Now on to ERG's generation portfolio, managed by our centralized Energy Management: it is a fairly sizeable portfolio, as you can see on **page no. 8**. During the quarter, ERG managed roughly 3.5TWh of energy, of which almost 2.1TWh generated by our portfolio of assets. The remainder was purchased on the Market in order to adjust our supply profiles, optimize the portfolio and perform hedging strategies, in line with our risk management policies.

As far as sales: 0.5TWh was the electricity sold through a bilateral contract to IREN, 0.1TWh to site customers, and the rest was sold on the Wholesale Market.

Let us now move onto **page no. 9**, commenting Wind operations. EBITDA was €104mn, down 11% YoY mainly as a result of very weak wind conditions, particularly in Italy and France.

Overall Production was down 13% (-164GWh in absolute terms). Load factor at 29% vs. 33% last year, as a result of a -15% decline in Italy, a -25% decline in France, but also a -5% in Germany. I think it is important to say that the availability of our plants was above our budget - between 97% and 98% - so this effect on the production is entirely due to the lack of wind.

In Bulgaria and in Romania we had better wind conditions, whilst in Poland we had pretty in line productions.

All-in-all, the quarter fell short by some 165GWh compared to 1Q 2016 with an associated economic impact of roughly €30mn, out of which about €3mn associated to the phase-out of incentives net of recovery from past limitations. Thus, even excluding

the phase-out of incentives (which was expected), the volume effect on a like-for-like basis was negative for about €27mn. This effect was partly offset by a better price scenario (about +€13mn, already net of hedging settlements of about -€5mn) and, most important, lower fixed cost for about €4mn, associated to efficiency actions in the O&M space.

Now Programmable results, which include CCGT and Hydro. I am on **page no. 10**.

EBITDA was €50mn against €48mn over the same period of 2016, composed as follows:

1. CCGT EBITDA at €14mn vs. €27mn. The main effect here is the exit from the Essential Unit Regime, which determined a cost reimbursement of about €18mn in 1Q 2016. This effect was only partly offset by the better price scenario, with higher spark spreads and higher prices for white certificates, which accounted for roughly +€7mn contribution versus 1Q 2016.
2. Hydro generated an EBITDA of €35mn in the quarter, so a huge performance vs. €21mn in 1Q 2016. Production was 386GWh, pretty much in line on a YoY basis. Economics for Hydro benefited during the quarter from higher prices in the central-northern area, where the plant is located, with the flexibility of the plant to capture the peak-prices in the area. As already mentioned, 1Q 2017 results for Hydro benefited from the definitive entitlement for Cotilia and Sigillo power plants (roughly 50MW out of the total), to receive incentives as per the refurbishment investments made in 2010-2011. This is the result of having successfully completed all the required checks and tests with GSE. The economic consequence of this is that we were able to recognize in the period about €8mn of incentives related to previous years, on top of the €25mn already accounted in 2016 in the Hydro PPA (Purchase Price Allocation).

I will now comment on Investments. I am on **page no. 11**. Investments in the period were fairly limited to €11mn, mainly concentrated in Wind (€8mn) and mainly related to the construction of the Brockaghboy wind farm in Northern Ireland.

Now quickly on to TotalERG results, which are accounted on an equity basis. I am on **page no. 12**. As usual, to keep it simple, I will look at results for 100% of the Company, of which 51% is our stake.

EBITDA was €41mn, so considerably up (+37%) compared to €30mn in the first quarter of 2016.

Marketing Ebitda was higher on a YoY basis, mainly as a result of a favorable margin scenario mainly on Retail, with demand for oil products in the country pretty stable, as shown in the graph at the top left of the page. Refining enjoyed slightly higher margins, with the EMC indicator up from 2.8 to 2.9\$/bl, as shown at the top right of the page, with the overall performance of our refining and logistic assets much better than last year.

Being an equity investment, we nevertheless tend to look at Net profit. In this respect - thanks to higher operating results, associated to lower depreciation and financial charges - TotalERG Net Profit was €12mn, more than double compared to the €5mn in 1Q 2016.

To conclude on TotalERG, I would like to say that the Company is performing very well, as a result of the great effort made over the last few years to turn it around in the best way possible.

I will now comment on P&L on a recurring basis. I am on **page no. 14**.

I have already commented on Recurring Ebitda. So going down:

- Lower depreciation reflects the technical life extension, which took place in 4Q 2016 with reference to some wind assets in France, and
- Net Financial expenses were down YoY from €19mn to €16mn, thanks to the lower net debt, as well as the benefits coming from the debt restructuring carried out in 2016. As a consequence, the implied cost of Net Debt declined from about 4.8% in the 1Q 2016 to about 4.4% in the 1Q 2017.
- Income from Equity Investments (namely TotalERG) was €6mn in the quarter vs. €2mn last year.
- Tax rate was 24% vs. 26%, down further mainly thanks to the downward revision of Italian Corporate Tax from 27.5% to 24.0% effective as of 1.1.2017. This effect was partly offset by a reduction in yields on ACE fiscal regime (from 4.75% in 2016 to 2.3% in 2017) as well as the reduction of the validity period on which to calculate the fiscal base for deductions, now limited to from 2013 onwards.
- 0 Minorities, following the last year agreement with Unicredit.

As a result of all this, Recurring Net Profit was €61mn in 1Q 2017, +7% vs €57mn in 1Q 2016.

Now the cash flow statement for the period. I am on **page no. 15**.

Net cash generation was €93mn, and reflects a positive €151mn of cash Ebitda (already mentioned) and a negative €11mn of CAPEX (already commented), €38mn change in working capital (mainly related to the seasonality in the cash-in of incentives), and €16mn of financial charges.

I would like to draw your attention to the fact that the NFP at March 31st 2017 was similar to that at the end of 2015, notwithstanding that we invested roughly €400mn in assets (mainly through M&A), and paid dividends of about €140mn in the meantime. In other words, the Company generated roughly €550mn of net cash over the last 5 quarters, which I believe is quite an impressive pace of deleverage.

I hope I have touched on all the key items, so I will now hand you over to Luca for his final remarks.

Luca Bettonte:

Thanks Paolo.

Now the guidance for 2017. We confirm what we have already said: no news in the end.

EBITDA at €430mn: we confirm our view for the whole year 2017, although we are a bit ahead of the budget.

In Wind business (slightly down vs. last year), the loss of revenues from the phase-out in Italy during 2017 of some 214MW from the incentive scheme would be just partly offset by higher unit incentive value per MWh, and from the recovery of the value of the loss of production, due to past years limitations imposed by the National Grid Operator.

We forecast a better scenario for energy prices in Italy, but still in Italy a lower energy generation, also taking into account the low cumulated production we have seen at the end of April. Everything will be just partly offset by a larger production abroad, thanks to the newly acquired wind farms in Germany, and to the wind farm being built in Northern Ireland, up and running from the fourth quarter 2017, but whose profitability is anyhow lower than that in Italy.

In Thermal business (for sure down vs. last year): Essential Unit Regime for CCGT ended in May 2016, while the interconnector began operating (last year contribution to fixed costs and capital remuneration accounted for some €31mn). So something is helping us to partly offset this:

- higher value and volumes of the TEE/white certificates
- better margins as a result of the price trends for energy and gas
- good contribution from the Dispatching Market Services

In any case they are not enough to offset the impact of the mentioned €31mn.

In the Hydro business, the Ebitda forecast is up vs. last year, because of a better energy unit price scenario in the Central-North zone and higher unit incentive value per MWh, but we fear that a dried season could come, and that implies lower energy generation. However, here again the Dispatching Market Services will give a strong contribution.

In the end we maintain our forecast still based on a weaker performance in Wind and Thermal Generation, as a consequence of the phase-out of incentives, the end of the Essential Unit Regime (as per our Business Plan), on top of which a lower than expected electricity generation in Wind has to be added.

All these negative effects are partly offset by better results in the Hydro Generation, the contribution from new wind assets, and better than expected Italian energy price scenario.

As far as CAPEX at €140mn, we are on time and on budget as for the new installed capacity, having secured almost 100MW out of some 200MW forecast in our Business Plan: 48MW from the last acquisition in Germany, and 48MW to be up and running before year end in Northern Ireland.

Net debt guidance is at €1.45bn from the previous €1.56bn, a deleverage of some €100mn, which includes the dividend distribution and, for the time being, it is not including any proceeds from the potential sale of our stake in TotalERG.

And now we are ready to take your questions.

Questions & Answers

Operator:

Excuse me, this is the Chorus Call conference operator. We will now begin the question and answer session. The first question is from Nicolò Storer with Mediobanca. Please go ahead.

Nicolò Storer:

Yes, thank you for taking my questions. I beg your pardon, if my questions have already been answered, but I was able to connect to the call only after the beginning. The first question is on the competitive scenario for new investments, which is getting tougher and tougher over the past few months, or are you seeing good opportunities ahead? And the second question is on the Italian situation, with all the repowering issue: how do you think that it can be possible to have a new incentive on repowering, considering the price at which new capacity to be installed has recently been awarded? Thank you.

Luca Bettonte:

Okay, right. So I can put your questions together, answering both of them, saying that, if I look at what has just happened - I am referring to both the new regulation in France and the National Energy Plan (i.e. the guidelines that we saw first yesterday) - I think that I have to be positively oriented towards the new possibility to invest in Renewables, because the signals are quite clear: although with some differences, what France is doing is quite clear. They are launching an auction process through which they are asking people to bid for some 1,000MW per year in two auctions with the entering price for the auction, that is something similar to 75€/MWh.

So a clear signal, a clear message from France that they are going to push the Renewables, in particular the Wind industry. And, if you add this news to what is already happening in Germany, I think that the two markets we are targeting for our growth going forward are acting properly, in our opinion.

Going back to Italy, as you know, we were the first Company maybe to introduce the concept of repowering: it was easy to do, because we own the most interesting places where wind is blowing a lot, and with a very old technology (I remember you the acquisition in 2013 of the wind farms from Gaz de France). And now, we are happy to see that both in the Winter Package and in the SEN, the National Energy Plan – or NEP, I do not know how you prefer to call it - there is a specific indication that repowering is going to be one of the best way to proceed to renew the wind farms in our country.

Taking into consideration incentives, as per your specific question, as I have been saying for months, I no longer need to receive incentives. I know - and that is written in the SEN - that solar and wind are two mature technologies, and we know very well, that are becoming more and more competitive. Then competition must be based not on incentive but on real competition through auctions: that is what is happening in Germany, and also in France. So I am not expecting an incentive for the repowering. What I need is just to be put in a position to compete, because we are industrial operators. We are squeezing as much as we could the LCOE in order to be competitive

through the auction process. And I think that what is written in that direction in the National Energy Plan is what we were expecting to see.

Nicolò Storer:

Thank you. Thank you very much.

Operator:

The next question is from Paolo Citi with Intermonte. Please go ahead.

Paolo Citi:

Hi, good morning. I have a follow-up question again on the sector outlook, in France and in Italy in particular. I did not catch exactly the figure you said regarding the auction process prices in France, so could you repeat this? And then again on the repowering in Italy, I would like to better understand what your proposal could be on the discussion underway with the Government. You said there is the possibility that at the end there could be PPAs schemes for repowering assets or not. And then on the guidance of the P&L, if I catch correctly, you said the tax rate was 24%. Could this be a guidance also for the full year? Thanks.

Luca Bettonte:

Okay. In France, it is something really very, very new, because the news is from yesterday. There is going to be a three-years auction process, two auctions every year with an installed capacity of some 500MW each - so 1,000MW every year. So in Germany the amount is larger: 2.8GWh per year, at the end. The entry price for the auction is 74€/MWh. For sake of completeness let me just add that all the wind farms that have less than 7 turbines with the cap of 3MW in terms of power installed per WTG per tower, should not take part in these auction processes. But they keep on going through the existing incentive mechanism: that is what France got from the European Union. Of course, we have to analyze deeply this new regulation, because it has just been issued, and it is still being issued to a given extent. But in any case it sounds very positive for us, it is what we were expecting.

As far as repowering, we would like to be put in a position to compete for repowering. Of course, you know, everybody recognizes that to use the existing highly windy places with the old technology to be substituted is the best way to keep on growing in the Renewables. So now, we are waiting to see what is going to be put and written in the document that should follow these guidelines, and should be put on the table by the Government, by the Ministry for a public consultation, in order to see really what they think is going to be the competitive framework for this specific development.

On our side, what we like to have is, for sure, dedicated auctions. But, we understand that competitiveness reduction of the price of energy is crucial for the Government, and we agree of course as Italian citizens. So no problem if we have to compete with others. What is important is that the rules should be based on a competitive and open market with fair rules, in order to allow the industrial operators to exploit at best their capability to squeeze the production cost, and so to be competitive when taking part in the auction offering their price.

As for the P&L, the tax rate is going to be in between 25% and 26% in our guidance, because we do not have to take into consideration the corporate income tax, but the order of taxation that is affecting the overall tax rate for the year.

Paolo Citi:

Thank you. Thank you very much.

Operator:

There are no more questions registered at this time.

Luca Bettonte:

Okay. Fine, thanks a lot everybody. Have a nice day. See you in summer for the first half results. Thanks a lot. Bye-bye.