

ERG S.p.A.
“Second 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 Second 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 everybody and thanks for coming to this conference call on our Second Quarter 2017 results. Here with me, as usual, there is the CFO, Paolo Merli.

As usual, we start by underlining our key figures for the period (as per **page no. 4**), and I dare to say we posted very good results, despite we worked in a very tough scenario.

Let me remind you that during the first six months of the year - and in particular in the second quarter - the generation both in wind and in hydropower was very low, due to adverse weather conditions, of course from a business standpoint: we had just sun, low wind and almost no rainfall. As a result, in the first half we lost some 265GWh in wind in Italy (148GWh just in the 2Q17), while abroad – on the other hand - the production was higher by 25GWh in the first half (51GWh in 2Q17). In hydro we lost some 100GWh, and all of them in the second quarter of this year. As a result, all in all, on a half-year basis we posted some €55mn lower EBITDA just due to the lower volumes produced, and in addition, in wind, in the first half of 2017 some 141MW went progressively out of the incentivised regime, bringing about some €10mn loss in revenues.

Furthermore, let remember that in the first half of 2016 the thermal generation benefitted of some €31mn from the Essential Unit Regime, expired in May last year.

Despite all of that, on YoY basis EBITDA came in at €107mn vs €111mn of last year, while on a six-month basis at €258mn vs €273mn.

This has been achieved thanks to the contribution of the Energy Management that has operated very well, leveraging on the assets flexibility, as well as on the assets complementarity, in a quite favorable price scenario, that allowed us to offset most of the mentioned losses.

In summary, as for the thermal generation:

- National Energy price (PUN) on average was up 30% in the 2Q17 and 38% in the first half; this increase, associated with a lower increase of the price of natural gas, has led to a wider spark spread. Along with that,
- production of White Certificates, while almost in line with the previous year, benefitted from higher prices due to the specific market trend, so far, in 2017

As for the hydropower:

- flexibility of the plants allowed to sell the power produced mostly during peak hours, exploiting at best the high prices in the North-Central Zone
- it is worth mentioning the positive contribution related to the recognition in 2017 of some Green Certificates of the previous year for about €8mn.

And last, as for wind farms:

- as already mentioned, higher electricity prices and higher unit value per MWh of the incentives helped offsetting most of the loss of production, as well as
- the recovery of some €5mn related to the loss of production imposed by the TSO to those wind farms already phased out from the incentive regime.

These are the reasons why we posted so very good results, from an EBITDA viewpoint.

On the contrary recurring net profit is higher in these first six months: €87mn vs €74mn, and by €10mn on YoY basis. Commenting just on the 1H17 strong result, we posted it thanks to:

- lower financial charges from the ongoing restructuring of a relevant portion of the financial indebtedness that is generating savings, associated with a lower average indebtedness over the period
- lower taxation, mainly as per lower Corporate Income Tax rate, and
- higher contribution from TotalERG, that posted very strong results in the first half of 2017

And in the end lower Net Financial Position, with the Group that keeps deleveraging. In the first half of 2017 the cash flow before Dividends (€74mn) and M&A (€40mn) was about €160mn.

Having said that, now I will hand you over to Paolo for his analysis.

Paolo Merli:

Thanks Luca, good morning everybody.

I will start as usual with a brief overview of the power scenario in the second quarter.

I am on **page no. 6**. Let us start by commenting on Power Demand in Italy, as you see in the bottom left graph of the chart.

National Electricity Demand was up 2.2% YoY during the quarter. The period was affected by adverse weather conditions, characterized by a very dry season and very little wind. As a matter of fact, wind contribution to demand in Italy was down by 19%, Hydro down by 20%, while the difference was made up by the Thermal, which was up by 13%. Nevertheless, the lack of renewable production coupled with rising demand in the period (also pushed up by a very hot season) drove to a significant increase in prices during the quarter. Against this backdrop, our wind productions in Italy were down 26% YoY, basically due to our asset location across regions with our traditional overexposure, versus the national average, to Campania and the two main islands (Sicily and Sardinia), where wind was weaker than in other areas of the country, such as the Adriatic coast. Our Hydro production was down 27% - thus weaker than industry - due to the extremely poor rainfalls in Central Italy, where our plant is located. Contrary to the Industry trend, our CCGT production was down 4% YoY, basically as a result of the exit from the Essential Unit Regime.

Now let us comment on prices in Italy: the Average National Price in Italy was 45€/MWh in 2Q 2017, +30% year-on-year. The increase in prices experienced in the quarter was mainly related to the rising demand, coupled with a short in the supply from renewables in the period. Price indicator for Renewables in Italy – the one we are looking at more - including Feed-in-premium, was 152€/MWh, +12% YoY. Prices in Sicily were quite satisfactory, trading at a premium vs. PUN of roughly 12€/MWh (against +5€/MWh in 2Q 2016), following the rise in demand, the end of Essential Unit Regime and the decline in the wind production.

Generation margins were quite satisfactory in the quarter, significantly up YoY, although down QoQ as the situation in France was back to normal during the period, after the disruptions, which affected prices all-through the 1Q 2017, in particular in Northern Italy. During the quarter our CCGT benefited from the pricing scenario in Sicily, as well as – I should mention this - from spikes in White Certificates Prices, as our gas-fired plant is classified as Highly Cogenerative and, as such, is entitled to generate roughly 100,000 White Certificates per year. Price for White Certificates spiked at their historical highs during the quarter at an average of about €220 per certificate, roughly €100 more than in the same period of 2016, thus becoming more and more an important stream of revenues for our CCGT.

Let us comment quickly abroad. In light of our exposure to feed-in-tariffs in France, Germany and Bulgaria the impact from the price scenario was limited, as shown in the chart, with the exception unfortunately of Poland, where the general environment is still very very challenging, with sale prices – already including the Origin Certificates - down significantly YoY, as you can see from the chart.

Let us see Economics for the Group in a nutshell over the First Half, which I think is more representative of the performance of the Group in 2017 so far. I am on **page no. 7**. EBITDA was €258mn - down “only” 5.5% YoY – we indeed could say “only” given the sharp reduction in productions from Wind and Hydro (with a total negative effect of €50mn), the phase-out of incentives with a negative impact of €5mn (already net of recovery from past limitations, but still it is in the book) as well as the tough comparison for our CCGT plant, following its exit from the Essential Unit Regime, which entitled the plant to have roughly €31mn of cost reimbursement over the first semester of 2016. So if you add all-together these negative items, you will have a negative impact of roughly €80mn. But those negatives were mostly offset by a mixture of items, among which I should mention the better price scenario (including the white certificates prices) which more or less offset the volume effect, a higher contribution from our Energy Management, the recognition of some €8mn for past incentives associated to some Hydro Plants, the contribution from the newly acquired wind farms in Germany and, last but not least, a further significant cost reduction, which we tend to associated to One Company re-organization, effective as of January 1, 2017.

So, all in all we are very enthusiastic about the Company's performance over the First Half, even better than our budget, despite the extremely adverse wind and hydro conditions.

Let us move to **page no. 8**, as usual for a quick comment on ERG's generation portfolio, which is managed by our centralized Energy Management. It is a quite fairly sizeable portfolio.

During the semester, ERG managed roughly 6.1TWh of energy, of which almost 3.6TWh generated by our portfolio of assets. The remainder was purchased on the Market, as usual in order to adjust our supply profiles, optimize the portfolio and perform hedging strategies, in line with our risk management policies. In this respect I should say that the hedging strategy performed during the semester due to the very high spikes reached by the prices accounted for roughly €9mn negative in terms of Mark-to-Market. It is important to say that, because net of this effect under the actual scenario of the semester the results would have been not that far from those in 2016, notwithstanding all the negative items we have several times mentioned these days: the little wind and hydro, the exit from the Essential Unit Regime, etc.

Let us move to **page no. 9**, commenting segment by segment, starting from Wind. EBITDA - now I am focusing again on 2Q 2017 - was €66mn, down more than 5% YoY mainly as a result of the very weak wind conditions, particularly in Italy and France.

Overall production was down 12%. Load factor was 19% vs. 21% last year: in particular, production in Italy was severely down by 26%, and in France down by 9%. In terms of production this was partly offset by the good performance in Germany, in particular thanks to the contribution from the new assets, with production in the country up 50% YoY. Also the production in Eastern Europe was quite good, driven by Poland and Romania.

So, all-in-all the quarter fell short by some 100GWh, with an associated economic impact of roughly €25mn (I am now commenting the quarter), which compares with roughly €50mn over the semester.

Another important point to remind is the phase-out of incentives: as anticipated in our Business Plan, about 214MW are phasing out the incentive life in 2017, of which 141MW already out at the end of June 2017. It is nothing different from what we said showing our Business Plan but I think it is important to remind this item.

The volume effect, as mentioned before, was only partly offset by the better price scenario and - even to a lesser extent - the lower fixed costs.

Now Programmable results. I am on **page no. 10**. EBITDA was €44mn, broadly in line vs. the same period of last year.

The CCGT plant posted an EBITDA of €25mn vs. €24mn: slightly up, despite a YoY tough comparison as in 2Q 2016 our CCGT still benefited from the Essential Unit regime, with cost reimbursement for about €13mn. This effect was more than offset by a mixture of positive items, such as higher spark spreads in the period, higher MSD revenues, higher prices for white certificates, as well as lower fixed costs.

Hydro operation performed really very well, considering the dry season, and generated an EBITDA of €19mn in the quarter, practically in line with last year but with production

down by 28% compared to last year. The drop in production was partly offset by higher prices, also thanks to the high flexibility of the plant to capture the peak prices in the Central-North area, quite high during the period.

I will now comment on Investments over the semester. I am on **page no. 11**.

Investments in the period were €66mn, mainly concentrated in Wind (€60mn), of which €40mn for M&A and referred to the acquisition we made in Germany from Dutch Infrastructure Fund. Remaining Capex in Wind mainly refer to Brockaghboy wind farm in Northern Ireland, whose construction today is almost finalized and is expected to be completed by the end of September 2017. During 4Q 2017 there gonna be the commissioning phase, and then the accreditation of ROCs (i.e. the local Green certificates) will occur probably by the end of the year.

Though it is not included in our Capex item, I think it is worth mentioning that in the quarter ERG acquired a fully authorized project (35MW) in Northern Ireland, very near to Brockaghboy: you will find the cash out of about €4mn in our cash flow statement, and as capitalized item within our financial assets in our balance sheet.

The remaining investments – just few millions euros - were associated to ordinary maintenance.

Let us now comment on to TotalERG results (I am on **page no. 12**), which are accounted on an equity basis. And here I am glad to comment very solid results.

As usual, to keep it simple, I will look at results for 100% of the Company, of which 51% is ours.

EBITDA was €47mn, more than double the result obtained in the second quarter of 2016. In particular, Marketing Ebitda was significantly higher on a YoY basis, mainly as a result of a favorable margin scenario on Retail, with also the oil products prices declining on the market, thus resulting in higher margins for this kind of activity. Refining enjoyed higher margins as well, with the EMC indicator up from 1.9\$/bl to 3.3\$/bl.

So, all the segments of TotalERG were performing very well during the quarter. But being an equity investment, we nevertheless tend to look at Net profit. In this respect results were even better, thanks to higher operating results, associated with lower financial charges and tax rate. So the Net Profit was €17mn in Q2 (vs. €0mn in the same quarter last year) and €29mn in H1 compared to €5mn in 1H 2016, so almost 6 times more.

Let us now conclude commenting on P&L on a recurring basis. I am on **page no. 14**.

I have already commented on recurring Ebitda. So, going down:

- the slightly lower depreciation reflects the technical life extension on some assets, as of 4Q 2016, with reference to some wind assets in France, partly offset by the consolidation of the newly acquired wind farms in Germany
- Net Financial expenses were down YoY as a result of a lower net debt ,as well as of the benefits coming from the debt restructuring carried out in 2016.

- Income from Equity Investments (namely TotalERG): as already commented, €9mn was our 51% stake in the quarter vs. €0mn last year.
- tax rate in the quarter was 21% vs. 37%, down further mainly thanks to the downward revision of Italian Corporate Tax from 27.5% to 24% (effective as of January 1, 2017) and higher contribution of TotalERG results which are already net of taxes. All these positives were partly offset by a reduced yield on ACE regime (as the yield moved down from 4.75% in 2016 to 1.6% in 2017).
- 0 Minorities following last year's agreement with Unicredit, through which ERG bought back the minority stake in its ERG Renew subsidiary, before it was merged into ERG Power Generation as part of the One Company reorganization.

As a result of all this, Recurring Net Profit was €27mn in 2Q 2017, +59% YoY which I think is a terrific bottom-line performance.

The First half Recurring Net Profit was €87mn, +18% YoY.

Now to conclude, the cash flow statement for the period. I am on **page no. 15**. Net operating cash generation was €157mn, and reflects a positive cash Ebitda, partly absorbed by CAPEX, change in working capital - mainly related to the seasonality in the cash-in of incentives - and €34mn of financial charges, plus other positive effects for a total positive of €13mn, which again generates from a mixture of items: the dividends received from TotalERG, the cash-out for the acquisition of the Evishagaran project in Northern Ireland, the €15mn taxes paid in the period, the positive effect from the reduced negative fair value associated to the hedging in project financing, and so on.

The Net Operating Cash Generation was practically re-invested in €40mn of M&A, in €74mn of dividends distributed in May to our shareholders, and in €40mn of deleverage which brought the net financial position at €1.5bn at the end of June, not far away from the guidance for the end of the year.

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. As for guidance we confirm our year-end targets:

EBITDA at €430mn, despite also 1H 2017 results were above our expectations, but – as you know, there is always a “but”...

- we see a better energy price scenario going forward in Italy, though the difference versus last year should decrease or even reverse towards the end of the year, and
- in Wind in Italy we do not envisage any higher production, although in July the GWh generated were in line with the budget, so the result should be lower than last year; only abroad the performance should be in line, thanks to the newly acquired German wind farms contribution
- as for the hydropower, its production in July was still lower than expected, but in this case the higher prices associated with the plant flexibility - along with the contribution from the former green certificates recognized - would allow to post better results

- thermal generation will continue to benefit from a wider Spark Spread, as in 1H 2017, but unfortunately it should not be enough to improve the final result versus what we got last year.

So let me tell you we stay where we are: €430mn of EBITDA.

CAPEX guidance is 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 (the Brockaghboy project).

Net debt guidance is at €1.45bn from €1.56bn in previous year, with a deleverage of some €100mn. Once again, for the time being we are not including any proceeds from the potential sale of our stake in TotalERG.

Now we are ready for two things: first of all to go on holiday, but also to take your – I guess few... – questions. Thanks a lot.

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 Roberto Letizia of Equita SIM. Please go ahead.

Roberto Letizia:

Yes, good morning. Just a couple of quick questions from my side. So you are currently above budget. Can you explicitly precise how much are you above budget so far, in order to give us an indication of what is the buffer you currently have to absorb eventual additional negative conditions during the second part of the year? And the second question is related to the disposal of TotalERG: can you provide us with any update on the process? Thank you.

Luca Bettonte:

Hi, fine, two quick questions. The first has no answer. And the second...

Roberto Letizia:

A quick answer.

Luca Bettonte:

Yes, really. So, for sure, a good question, I would say if I were British but I am Italian. So as I often say, it is not a matter of how much is the difference between the budget and our actual results so far, let me say it is related to the past. It is not a matter of buffer: what is important is what is going on looking forward, you know, and I have to go back to what I have just said. Considering we started with the loss of some €50-55mn from lower volumes, and we no longer have €31mn from the Essential Unit Regime - that is a minus €90mn - I think that my people did a very good job during this first half. But

although we have a buffer as you are telling us, I think that is better so far - at least till the next reporting season in September/October or November - to keep on suggesting you that we want to keep our forecast.

With reference to Total ERG, it is quite simple to say: it is not possible to give you any comment, because the process is going ahead. Let me just tell you that I confirm what I told you a couple of months ago: the process is going ahead well. So the potential buyers are people that have a very high financial operating and business reputation. So far, we are in talks with them, negotiation is going ahead well. And so, let me tell you that we think we are going to have something finalized before the year-end. I cannot tell you anything more than that.

Operator:

The next question is from Roberto Ranieri of Banca IMI. Please go ahead.

Roberto Ranieri:

Yes, good morning gentlemen, two quick questions from my side. The first one is a clarification on figures. Forgive me, but I probably missed some figures, specifically on the Green Certificates phase-out impact in the first half. What was the effect on the EBITDA from the white certificates you sold on the market? My second question is on figures as well, on financial expenses: did you have any one-off component in the financial expenses in terms of derivatives or others? And can you give us a guidance for the full year 2017? That is it. Thank you very much.

Luca Bettonte:

Right. So I will try to answer you, in any case Paolo is quite close to me, so he can correct me. In terms of phase out of Green certificates, the impact is some €10mn, but you have to offset it with the €5mn that is what we are recovering from the loss of production imposed us by Terna in the previous year, relating to those plants that are out of the incentivized schemes. And so, the net impact in the first half is €5mn.

From a financial view point, Paolo...

Paolo Luigi Merli:

Yes, before you ask about the white certificates, I can tell you that in the first half of the year, the revenues associated with the white certificates were €23mn against €9mn over the first semester of 2016, so plus €14mn. Part of this amount is related to the revaluation, the write-up of the white certificates produced in 2016, which were accounted - not yet sold - in our financial statement at €120/118 per certificate, while today the 2016 certificates have been sold at €226, thus the capital gain was included in the semester.

About the financial charges: no, I would say there are no special items, and going forward we are expecting that the savings you have seen in the first half will be again replicated in the second half or even more, because the deleverage keeps on, and also the actions deriving from all the restructuring are fully in place. So we are expecting the bottom-line to keep enjoying from the low part of the profit and loss statements.

Roberto Ranieri:

Okay. Thank you. Can I ask a follow-up question, just a clarification anyway? So basically on white certificates: €23mn revenues, a part of it from revaluation, but you expect to cash-in this revaluation by the end of the year...

Paolo Luigi Merli:

Part of it has already been cashed, because we sold all the 100,000 generated in 2016 a few days ago through a bilateral contract with an operator in the Market at €226, that means €23mn more or less of cash-in.

Roberto Ranieri:

Okay.

Paolo Luigi Merli:

Which is expected to be in the third quarter.

Roberto Ranieri:

Okay.

Paolo Luigi Merli:

While the ones generated in 2017 will be available for sale next year, in July - according to the normal rules in this kind of regulated market - but they are accounted in our profit & loss at the current market price, which is more or less in the region of €220 per certificate.

Roberto Ranieri:

Okay, okay. Thank you, Paolo.

Operator:

The next question is from Sara Piccinini of Mediobanca. Please go ahead.

Sara Piccinini:

Hi, good afternoon, everybody and thanks for taking my questions. The first one is on the pricing scenario: you are expecting a normalization of the scenario through the second half of the year, but given the strong results in hydro and CCGT, thanks to the pricing, I would like to ask you if it is possible to give a sensitivity of the EBITDA at PUN price movement? Also with reference to the white certificates, if I understood correctly, this is a specific price for this year particularly favorable regulatory framework. So do you expect this level of pricing to be maintained also in the second half and in the following years, or do you expect the prices to normalize around €100 like in the past? And the final question is just your opinion about the National Energy Plan: the latest news flow says that the discussion could be postponed to September, but yesterday there was a letter from the Parliamentary Commission asking for clarity for the regulatory framework on the repowering. So I would like to ask you if you expect the repowering topic to be addressed by the year-end, and if this could be part of your Business Plan? Thanks.

Luca Bettonte:

Okay. As for the first question on energy prices going forward, for sure we are expecting a lower average price in the market compared to the one we saw in the first half. What is important is that, looking forward and comparing the price for the next six months forecast with the prices we had last year, you should remember that in November – and particularly in December 2016 - prices were very high, because the French affair was starting that month. So in any case, our expectation going forward is to see an average national price that would be in the range of 49- 50€/MWh: that is what we have included in our forecast.

As for the hydro plant, to give you a sensitivity, it is quite easy for you if you take the price at peak during the first half, which is the price we sell most or all of our production in that region. So, I guess you can make your calculation on that.

As for the pricing of TEE - so the white certificates - for sure this year seems to be an extraordinary one but, if you look at the trend from a couple of years ago onward, the price has been growing. For 2017, based on the existing regulation on the market and the way the market had exchanged these Green certificates, you can make the calculation on the price that the Authority can use in order to buy these white certificates, although - as Paolo has just told you - we sold 2016 production to a third party on a private over-the-counter agreement. Our expectation is that the prices should stay as they are today. Though looking at what happened in the last auctions, the prices were by far higher than what we were expecting; so in any case, we keep on having such a view going forward.

National Energy Strategy: there is a lot of discussion, I think that is why the Minister is asking the operators to postpone the deadline to send out and to deliver their position. Of course, we are among the main important ones, in particular in Renewables, so we are working very hard inside the relevant associations. So, wait and see: we have heard the final date for delivering our opinion should be postponed by a couple of weeks. Talking about our opinion in particular on repowering, everybody is pushing the repowering, we too as well for sure. So I do not want to go again through the reasons why it is sensible, and also sensitive to have such an opportunity. The problem has mainly to do with the permit relating to the existing regulation, that is blocking any possibility to obtain for instance a fair regulation that would allow to go through auctions as for the new plants. In my opinion it is important to underline that nobody is talking about the use of ground in particular. That is going to be considered not just for the repowering, but also for the new plants. SEN is telling everybody that we should improve the amount of Renewables to be installed going forward. Fine, I am happy to hear that, but I am also asking where to put these new assets in Italy: that is the point.

So, it is easy for me to go back to the repowering: repowering without increasing the ground used should allow the operators to improve the power installed, and then to be in a position - through maybe auctions without incentives – to install new capacity. So, wait and see: there are some problems relating mainly to the permits and mechanisms so far.

At ERG, we are working very hard. We are submitting our projects also to the local authorities. We are working with Terna on that, because the rationale to do this

investment is quite clear for us. So wait and see what the Government is going to tell us in the next months.

Sara Piccinini:

Many thanks.

Operator:

The next question is a follow-up from Roberto Letizia with Equita SIM. Please go ahead.

Roberto Letizia:

Yes, sorry, I have a follow-up on the savings, specifically the one project program. I understand from your indication that also the savings basically are going better, among the things that compensated for the weaker weather condition. But, if I understand correctly and savings are going better, is that simply an anticipation of the same part of expected savings, or actually things are going better, in the sense that the amount of savings that you are going to extrapolate from the project is proving to be higher than initially envisaged? Thanks.

Paolo Luigi Merli:

Roberto, as I mentioned during my review of results, one of the items which contributed very much to this very good performance over the first semester was the fixed cost: fixed costs in general were considerably below last year, I think something like €7mn below 2016. And we tend to save also probably the same amount, or even more compared to our budget. We think – even though maybe it is too early to say - that this is also the result brought from the One Company reorganization. As you know, we launched - over the last 8 to 9 years during which we transformed our company - three reorganizations, and any times they brought some benefits, and this is not an exception. So, we are quite confident that at the end of the year, more savings will be on our accounts: this time probably they will come more from business rather than from corporate, where we have already done a huge work over the last few years.

So, consider for instance that the launch of our unique Procurement in the Group is already bringing results. The further internalization in the O&M space associated with the earnings curve during this kind of activities are bringing very brilliant results. And we hope this will be confirmed also for the forthcoming months. I hope I have answered your questions, Roberto.

Roberto Letizia:

Yes, of course, thanks a lot.

Operator:

Gentlemen, there are no more questions registered at this time.

Luca Bettonte:

Thanks a lot everybody. Have a nice summer break, and see you and speak to you in November. Bye.

Paolo Luigi Merli:

Bye.