



ERG S.p.A.
“Third Quarter 2015 Results”
November 12, 2015

MODERATORS:
LUCA BETTONTE, GROUP CEO
PAOLO MERLI, GROUP CFO

Operator:

Good morning. This is the Chorus Call Conference Operator. Welcome and thank you for joining the ERG Third Quarter 2015 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:

Thanks, good morning to you all and thanks for coming to this conference call. Let me start by saying that - as you have seen in the press release - our results on a quarterly basis were below what we posted last year in both businesses (€66mn EBITDA versus €80mn EBITDA in 2014 on a like-for-like basis), while on a nine-month basis we are in line with the previous year.

Let me comment on the key factors that have affected these results. In Wind, we had lower production compared to the last year, in particular in Italy (less 82GWh). And this was true particularly in July and most in August, simply due to less wind: at the same time let me remember you that last year July and August were two very extraordinary months from a wind availability viewpoint, so for a correct comparison we should take into consideration the higher portion of wind we had last year in the same period.

On the other side, we had higher production abroad - plus 68GWh - in all countries, in particular in France and Poland where we have installed and bought respectively 63MW (in France) and 42MW in Poland. In any case it is simple to understand that the profitability is down, because the unit selling price in Italy is by far higher than the unit selling price abroad. That is the main explanation of this reduction in the EBITDA margin, while fixed costs are under control, and the technical availability of the plant is very high and in line with budget.

Moving to the Power business results, EBITDA was €27mn compared to €33mn of the previous year. As you know, we have a new regulation in Sicily since the beginning of the year, and this has led to a strong decrease in the Sicilian unit selling price in this quarter. The lower EBITDA is also a result of this new regulation, that envisages that the plant is operating as an essential unit. So we have no longer the possibility to modulate, to bring home benefit from the Dispatching Service Market as we did last year, and this translates into a reduction on our profitability. In any case it has been offset - in a very relevant manner, because the difference is of just €5mn - in general terms thanks to the higher margins we have had from a higher clean spark spread for the sales to the market of the Power. Let me remind you the high quality of our selling agreement with the operators located in the site - industrial operators, our investment partners - and in the end the lower operating costs for running the plant, as the lower modulation means a lower stress for the machine in the end, and so we can save costs and that is the reason of this result.

On the other side on a nine-month basis, EBITDA is in line with last year: €264mn compared to €263mn. Let me tell you very simply that we had higher production in wind. Italy was down by 28GWh, but abroad we were up by 90GWh. In general terms the Power result is almost in line because we had on a nine-month basis a lower average

reduction of the Sicilian selling price. This is in general terms what happened from an EBITDA viewpoint.

Moving to the net profit, the situation was quite different: we posted €76mn as a nine-month result compared to the €54mn of the last year, so plus €22mn. So despite the equal EBITDA, we had a very good result, increased compared to the last year.

Let me tell you the main reasons: first of all, less financial expenses, due to a lower debt and the negotiation of some project financing loans that we have been able to achieve with the bank system. Then a better performance of TotalERG in all its business lines, retail and in particular refining (you know how low oil prices have been in the quarter). And a last reason is actually the lower tax, mainly because Robin Hood taxation no longer exists. All this has allowed us to post such a strong result.

In terms of net financial indebtedness, as expected it grew by about €140mn in the end. The main reasons are associated with the payment of the taxes on the capital gain we got last year from the exit of the CIP6 concession agreement (and the subsequent sale of ISAB Energy to LUKOIL), and the acquisition of the wind farms in France (approximately €70million), and the dividend distribution of about €71mn. But in my opinion it is important to underline that everything has been offset by a stronger funds from operation, that in the first nine months was €154mn. This is in a nutshell what has happened in the quarter: we have prepared here a slide just to recap what we have done in the Wind sector in October, i.e. the acquisition of 206MW from Macquarie: 124MW in France and 82MW in Germany. I do not want to go through the transaction, because I think that you know it very well; let me just underline a couple of messages.

First of all, we are growing in the two core countries for Renewables in Europe: as you know, Germany and France declared their commitment for a growth in this sector, and now we have a very strong position in France, where we are the ninth operator. And thanks to this acquisition ERG Renew is the eighth largest Wind company in Europe. What is important in my opinion is to underline not the fundamentals of the transaction (as you know them very well), but that we had been working to reduce or improve the country risk by geographical diversification, I think that if you look at the lower right portion of the slide, the pie charts show that we have already almost a 40% of our MWs installed abroad. I think that is a very good result achieved by people working in ERG Renew. That is all from my side, for the time being, so Paolo, please go ahead.

Paolo Merli:

Thank you, Luca. Good morning everybody. Luca already touched all the key elements of the quarter, so I will try to go quickly, and provide you with further details from a scenario and operational point of view.

Starting from the scenario, I will give you a brief overview starting from Italy. Here the average national price, the so-called PUN, was significantly up: €57/MWh during the quarter, i.e. plus 13% year-on-year, but in parallel the prices in Sicily went considerably down (from €95/MWh to €62/MWh) and you know how much prices in Sicily matter to us, as we have our CCGT plant and 200 MW of wind capacity installed in the island. The increase in the price on average in the country was driven by a surge in demand (+7%)

particularly in July and August, given the extraordinarily hot summer. It is also important to make you notice that the contribution to the demand from Renewables went down from 45% to 33%, but in particular the wind contribution to demand went down 16%. Our specific performance then in the Wind was even worse, because we are overexposed in some regions such as Calabria, Basilicata and Sicily, where the anemology was even tougher than the average of the country, and this is a matter of scenario.

In Sicily the reduction is totally related to the new regulation. So it is a quite tough comparison, because last year was a merchant market, while right now it is practically a totally regulated market, as all the units above 50MW of capacity (such as our plant) are forced to bid at the highest at their variable cost, and that is cooling off the prices significantly. As a matter of fact, the price in Sicily was more or less in line with the average in the country.

Moving to the right side of the slide, here you have the price including the green certificates which was positive for us (plus 6%), though the volume effect was fortunately more than offset by the increase in the prices, because as I said the anemology, the wind conditions were significantly down during the quarter, and also because last year was a quite good year, so tough comparison in this quarter from a wind point of view.

Looking at abroad, in the countries outside Italy where ERG Renew operated its asset base, you see that in France and in Germany the feed-in tariffs are more or less stable: €91/MWh and €96/MWh respectively, while there is a different picture in Eastern Europe, in particular in Poland and in Romania. In Romania you see that price was €69/MWh which includes green certificates compared to €80/MWh last year. Here I have to underline that both the Romanian and the Polish market - despite being different from each other - are in a quite challenging conditions, in the sense that they are both long of green certificates, and this results in lower prices for those certificates.

In Bulgaria apparently the price was more or less flat year-on-year at €95/MWh, which is in absolute terms a good feed-in tariff level. But in July some new rules around the price came in, with the introduction of 5% tax revenue, a triplication of the Grid fee the operators must pay to get to the Grid: so those effects reduced the profitability. And there has also been the introduction of a sort of cap on production, so that when the plants reach their cap, their threshold, the price recognized is no longer the feed-in tariff, but the so-called unbalanced price, which is much, much lower than that. That is why in Eastern Europe the scenario is very challenging; despite that we will see later that the contributions from operations outside Italy are growing significantly.

Okay, I think I touched all the items as regards to the scenario. In the backdrop of this scenario, Luca has already commented that the EBITDA for the Group was €66mn, minus 18% compared to last year: the decrease should be spread equally between the Power and Renewables segment. In a word: in Renewables much worse wind condition, and in the Power the new regulation. These are the two main effects. Let me also say that last year the tough comparison was not only in the Wind segment, but also in the Power, as last year under merchant conditions the price in Sicily was €95/MWh, with an exceptional high level of premium in the island compared to the Mainland.

I will now comment in more details segment-by-segment, starting from Renewables. Here the premise is that the quarter benefited from the change in the scope of consolidation as the 63MW acquired in France entered into the scope, and also the 42MW already installed in Poland entered into service, thus providing a higher asset base of roughly 105MW, operational during the quarter.

Despite that, the EBITDA was €45mn, minus 13% on a year-on-year basis. I think the best way to understand this performance is to break down the production: you see that overall the production went down 3%, but if you break down this figure between Italy (minus 19%) and abroad (plus 68%) you can easily understand the economic performance. The load factor in Italy was 15%, which is another angle to see how weak the quarter was from a wind perspective. Abroad was 21% against the 18% last year, so quite satisfactory; particularly in Poland, our first wind farm reported a 27% load factor, which is the highest of our asset portfolio. So from a technical point of view, the starting point of this plant is very, very encouraging though the scenario is not helping us to have the figures we expected at the time we decided to invest.

Moving to Slide no. 10 (Power results), this year the EBITDA was €27mn, minus 18% versus last year. But let me repeat once again that last year was an exceptional quarter with almost €45/MWh as a premium on the average national price, while this year under the new regulation prices were much lower, though partly compensated by the recognition of variable and fixed costs under the new regulation. From this point of view, let me say – but I will comment maybe better when commenting the cash flow - we accounted in the nine months figure about €56mn of variable and fixed costs to be recognized to the plant, but this amount has not been cashed in so far, so it is inflating our net financial position and reducing our cash flow over the period. So the negative effects of the scenario were compensated by the recognition of those costs, but also by a better, technical performance of the plant: as Luca said, despite running at a flat pace, the KPI of the plant were much better over the quarter. And also some contribution from the energy management as the unit is marketing all the energy, also that one coming from our wind assets.

Let us now comment on investments. I am at Slide no. 11: here investments are excluding the M&A, so about €70mn spent for the acquisition of the 63MW in France. I am commenting the nine months, as I think they are more representative of what the Group is doing in this respect: €69mn against €40mn last year, so plus 73%. I think it is worth noticing that €62mn out of €69 - so 90% of the total - were invested in the Renewables segment, coherently with our strategy. €62mn were mostly spent in Poland to develop our asset base, i.e. the first 42MW already operational and the further 40MW currently under construction, which should enter on stream by the end of the year. I repeat; those capex are not including the massive investments the Group is doing. Some have been already finalized (such as the 63MW in France), but most of them are still to come probably in the fourth quarter, when we expect the closing of the hydro transaction and also the further wind farms in France and Germany. As far as Power, I think there is nothing to comment, as they are just maintenance CAPEX.

I will now move to Slide no. 12 to comment on TotalERG, which posted a very exceptional performance over the quarter, but more in general over the nine months: in

particular EBITDA was almost double both in the quarter and in the nine months. I think it is important to say that a significant part of this increase was driven by the efficiency actions taken by the company last year, when they launched a re-organization which reduced the work-force by more than 100 people in the first half of 2014, but also the rationalization of the network, which is still going on. As a matter of fact, the number of service stations at the end of September 2015 was roughly 2,600, i.e. a 9% less than the same period last year, and this reflects the fact that the company is putting a big effort on reducing the loss-making or very low marginality point of sales.

On top of that, the refining unit reported very solid results thanks to the margins, and you can see the EMC margins almost quadrupled from 0.5 to \$4 per barrel, so that is boosting the segment of refining and logistics, that you can see in the quarter provided for €17mn EBITDA against the €4mn last year.

We see the net financial position of the Group was more or less stable, though last year there were some positive effects on working capital, reducing it. As you will find on our financial statement, on November 3 the company refinanced its medium-term facilities at very good conditions one year earlier than the natural expiration of the previous facilities (which would have expired on June 2016), and so the new facilities will provide the financing for the next five years with non recourse towards its shareholders and I think this is a great sign of trust and confidence from banks towards the future of this company.

Let us comment on the key financials, moving to Slide no. 14: I have already commented on EBITDA, depreciation is slightly up (€41mn against €40mn) reflecting the new enlarged asset base. Net financial income is €14mn against the €17mn, so minus 18%: this was because we had lower outstanding project financing debt, following the recent re-payments, and also lower margin after re-negotiating some margins with regard to few project financing facilities.

The yield from our cash management was in absolute terms more or less flat year-on-year, as the lower return was compensated by a higher amount of cash under management. Taxes were €5mn against €9mn: here I like to point out that the reduction of tax rate - which was 20% over the quarter (again almost half compared to 38% last year) - was due to the fact that the Robin Tax was cancelled, that there were lower regional taxes (the so-called IRAP), but above all that the contribution of net income from equity investments (i.e. the contribution from TotalERG) is already post-tax, so reducing considerably the nominal tax rate.

Anyway, the net bottom line, the net profit was €19mn, i.e. plus 32% against the €14mn last year. So I think quite solid results bottom line. Same message I would say from the nine-months view point, as the net profit of the Group €76mn was up 39% compared to the €54mn last year.

Last but not least, let us comment on adjusted cash flow. Here the comparison is against the 30 June 2015: you see the cash from operation (or EBITDA) was € 66mn. I think already commented in detail the working capital, which is mostly related to the

receivables toward the GSE as regards the recognition of variable and fixed costs, which – as I have already said - we expect to cash in next year.

Out of the total €56mn we accounted in this respect, €38mn are related to the first half of the year: we expect to cash them in by the year-end, and the guidance Luca will give you in a minute is consistent with this assumption.

I have already commented CAPEX and financial charges, and I think you well know what M&A and tax and other are about. So all in all, the net financial position at the end of September was €548mn with a leverage of 24%: it is perfectly in line with our guidance for the full year, which Luca is giving you in a second.

Luca Bettonte:

All right. Thanks Paolo. Not many comments on the guidance, I have already written down in the press release that we confirm what we told you a couple of months ago: so \$350mn for EBITDA, €230mn for CAPEX and a €600mn net financial position. EBITDA results at the end of September are in line with budget, and October even slightly better, so we are confident to achieve such a result, considering that in the wind sector at the year-end we are going to have 1.5GW. As far as investments, we have 100mn in Poland, €72mn in France and €27mn from the split of LUKERG Renew and thanks to this investment we are going to install and to have a larger installed base of 165 MW.

From a financial viewpoint, we confirm €600mn on a like-for-like basis for net indebtedness. As you know we are about to finalize the two acquisitions: one in the hydro business for €950mn, and the second one in the wind business, the wind assets in France and Germany for about €300mn. So you should add them at year-end because we are expecting to close in November the hydro transaction and before year-end the investment in wind. So that is all, 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 questions and answers session. The first question is from Roberto Ranieri of Banca IMI. Please go ahead.

Roberto Ranieri:

Yes, good morning gentlemen. Three questions, please. The first one is on the power price scenario in Italy: in the third quarter we have seen a slight increase versus last year, i.e. €55/MWh which is pretty high compared with the past. I am just wondering if this increase is sustainable in the future, if this €55/MWh wholesale price in Italy is sustainable, or will be stable in the future, according to your estimates or opinion. Second question: can you give us a normalized load factor for wind plants for the rest of the year and for 2016? The third question is on Sicily: in mid-2016 Terna expects the connection with the peninsula to be completed. So I am just wondering if we can expect some premium on the Italian wholesale price remaining, or just to be aligned to the

wholesale price in Italy because I am wondering if the Sicilian market will be different from the peninsular market, and in any case if there would be any alignment with the wholesale price in Italy. Those were my questions, thank you very much.

Luca Bettonte:

Okay, very good questions, looking forward to scenarios and also going ahead of this conference call, as probably you have put on the table some questions that I would expect to receive during the presentation of our business plan. In any case, I will try to answer. As far as scenario you asked whether power prices in Italy are sustainable in the long or in the medium term, based on what happened until now I do not think so in the end, because we have had an extraordinary spike in the third quarter as a consequence of a very hot season and that has affected the demand. The power demand was up almost 7% in the quarter, while on a nine-month basis it was up 1.9%, if I remember correctly. And this is an extraordinary situation. I do not think that in the medium term it is going to be sustainable, based on the existing structure of the same sources of energy in Italy. There is an over-capacity in any case, and it is difficult to see going forward a growth in power demand that allows us to have such a stable and higher long-term level in prices. So, that is the point.

Talking about the normalized load factor for 2015, it is a question I have never received before: our forecasts are based on the larger installed capacity that we have. Based on that, our production at year-end is going to be higher than the previous year, it was already higher on a nine-month basis, and therefore we are confirming the guidance at year end, because of two effects. First, there is going to be a lower production in Italy year-on-year basis, but with stable price, whilst abroad we are going to have a much higher production with lower prices. Combining the two effects plus a tight cost control, we are going to have a good performance by year-end higher than the previous year, that is the point. Sicily cable is going to come by mid 2016. It is difficult to say if some premium should stay afterwards, it depends on how the cable is going to work, it depends on the level of demand in Sicily; maybe a small portion could still be live from that point on, but first of all let us see if this cable will be really implemented and operational by the date that they announced, because many times this announcement was postponed. And that is all I can tell you now right now.

Roberto Ranieri:

Thank you. Very clear.

Operator:

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

Luca Bettonte:

Fine. Thanks a lot everybody and see you on the presentation of our business plan in a month's time. Bye-bye.

Paolo Merli:

Bye.