ERG S.p.A.

"First Quarter 2015 Results"

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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 First 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 a lot. Good morning everybody, and thanks for coming to our conference call to comment our first quarter 2015 results. Before going through the highlights relating to the first quarter, let me bring your attention to the slide no. 4, where we have prepared a restatement of our 2014 figures: in fact, in order to have a consistent and comparable like-for-like situation, we have to go back to last year and comment with you the main items we deducted from 2014 results in order to get them comparable with the results of the first quarter 2015.

On slide no. 4 let me start by commenting on EBITDA. In the first quarter 2014 we posted €168mn, whilst now we are comparing €107mn EBITDA, as from the first quarter of 2014 we deducted the contribution of ISAB Energy. You remember that last year starting from the 1 of July we sold to LUKOIL ISAB Energy: these €55mn are actually the contribution brought by the plant to the first quarter 2014. A similar comment applies to other three minor items related to TotalErg, Erg Supply & Trading (that is being merged this year in ERG, and whose activities have been stopped) and EOS (our Sicilian retail network sold at the end of last year). So we moved EBITDA down from €168mn to €107mn.

The same operation has to be done with the net profit, while for the net financial position the only deduction has to do with the net financial position of TotalErg by the end of 2014 (of course this is just the 51% owned by ERG). But for the accounting implication of this slide let me just have a simple comment that has to do with the magnitude of this deduction. Apart from ISAB Energy figure, the impact on the EBITDA of the Group in the first quarter of 2014 was negligible, as you can see here. So we are just simply aligning the core business representation of the Group to what the Group core business is going to be going forward. And again, in order to take into account the new industrial shape of the Group, starting from this year we have also deducted the TotalErg figures, as we no longer deem that to have TotalErg consolidated on a line-by-line basis represents in an appropriate manner our core business, in any case the business of the Group as a whole.

Moving forward to the slide no. 5, as usual here we have the highlights of our main figures for the first quarter, now compared on a like-for-like basis with what would have happened in the first quarter of 2014. Let me tell you that it has been a very good quarter again, as we posted €111mn of EBITDA in the first quarter 2015, up 4% compared to the first quarter of the previous year.

As you usually see in this slide, here you see that the positive contribution has been mainly brought by the Renewables sector that grew 11%, €95mn vs €86mn. So two main reasons: a larger production (in particular in Italy) and a slightly higher units revenue price for Renewables, again in Italy. While - as it was expected - we posted a lower EBITDA result (€22mn versus €29mn) in the Power sector: it was expected, you know, as a result of the introduction of the so-called amendment Mucchetti, i.e. a new regulation in Sicily, that has a very strong implication in terms of reduction of the premium price in the region.

Let me tell you that in terms of numbers: the premium price in Sicily in the first 2015 quarter was about €6 per megawatt hour (minus €16/MWh compared to the first quarter of the last year), and this has a relevant impact for us. Moreover, the price curve today in Sicily is flat, as a result of the mechanism introduced by the amendment Mucchetti, that has reduced the possibility for our plant to modulate, as well as it has reduced the income from the Dispatching Service Market. That is the reason why we have posted a lower result compared to the previous year.

In terms of net profit, still a good result: plus 15%, €34mn versus €30mn, thanks to the higher EBITDA, but also to better results and lower losses posted by TotalErg, now consolidated through the equity method. A higher EBITDA and TotalErg results have upset a higher depreciation, as well as higher financial charges that Paolo Merli is going to comment to you in details later on.

I finish my comment drawing your attention to the net financial position: down from €409mn to €335mn. As usual I would like to underline the operating deleverage that, by deducting what we spent from the M&A transactions, has been in the range of €83mn. It is again a good sign that the operating cash flow is strong for the Group, and our assets are good and well managed.

Now, Paolo I let you go on.

Paolo Merli:
Thank you, Luca. Good morning to everybody, and welcome from me as well to the conference call. Also my review will be based on the proforma figures that – just to quickly recap - take into account the discontinued transactions we had in 2014: in particular I refer to ISAB Energy, ISAB Energy Services going concern sold to LUKOIL (i.e. the IGCC plant and all the people providing O&M activities to that plant), the disposal of the equity participation in ERG Oil Sicilia which took place in December 2014, and the full exit from the Supply and Trading activities with a sub-holding (ERG Supply & Trading) to be merged into ERG SPA by the end of this month, without effect on the profit and loss in 2015, as the costs associated with this transaction had already been accounted in the 2014 financial statements.

As Luca said, from now on TotalErg will be represented just on an equity basis. We think the time is mature to give you this picture, which better represents the fundamental of the Group and the strategic path going forward, as Power generation becomes more and more our core business, on which probably also next business plan will be focused on.

Before starting the review of results, I would like to tell you that in the appendix you will find enclosed all the pro-forma 2014 quarters, so you can prepare your base comparison for the forthcoming quarters.

Now moving on to slide no. 7 regarding business environment during the quarter, consistently with my introduction on the re-shaping, we re-shape the format of the slide focusing just on power generation. On the left side you see that the price of energy in the country was more or less flat in terms of national average price (€52 versus €53 last year). Probably the main evidence in this slide is the huge reduction of the Sicilian price (minus 23%), but if you compare just the premium versus the country, the collapse of the premium in Sicily was of about €16 (from €22 last year to €6 in 1Q 2015) so about minus 73%. This has to do with the introduction of the Mucchetti Decree in the summer of 2014 which was followed by two deliberas from the Authority which set the rules through which all essential units (among which surely our CCGT plant) having an installed capacity higher than 50MW - which is the threshold defining essential units- have to bid according to some rules. Which in very, very few words means that each bid can't be higher than the variable costs of the plant. This results in an important drop of prices, but not only a reduction in prices, but also in volatility as Luca said before, thus reducing the revenues of the plant from the modulation and the flexibility of the plant plus lower revenues from the Dispatching Market.

All these negative items in the quarter were partly or mostly compensated by the reimbursement of variable and fixed costs which the plant is entitled for according to the new regulation, and in particular in the related fixed costs are included also the non cash cost, associated or deriving from the investments made in the past to build up the plant and not yet depreciated, including also a fair remuneration for the invested capital.

Surely this effect - and probably Luca will elaborate on it when giving the guidance - has also an effect on working capital in 2014, because the settlement provided by the Authority for the recognition of those costs is expected to be early next year in 2016, thus having a negative impact - but this is just a timing effect - on our forecasted net financial position at the end of the year.

Coming back to the environment, in general in Italy the demand was broadly flat year-on-year. The contribution from Renewables went down from 35% to 32%: here the main highlight is that the hydroelectric production over the quarter was considerably down (minus 26%), while Solar and Wind kept going up, respectively by 10% and 13%. In particular there was a quite positive wind quarter in Italy, even with some differences region by region, but anyway surely positive. Let me remind you that last year from a hydroelectric point of view was an exceptional, and surely big year.

Looking at the right part of the chart, you have here a picture of all the reference prices (including incentives, either through green certificates or through feed-in tariff) we are having in all our countries where ERG Renew currently operates. Surely it is evident that Italian prices are at huge premium compared to the average in the rest of Europe.

Moving to slide no. 8, let me comment very quickly the EBITDA: it was €111mn, i.e. plus 4% year-on-year. You see that the main contribution came from Renewables, while - for the reason already commented - Power was minus €7mn.

I now move segment by segment in more details. Coming to Renewables - I am at slide no. 9 - you see EBITDA was €95mn (up 11% year-on-year), reflecting a higher production: up 7%, all in all, even if with some differences depending on the country.

Load factor in Italy was 29% in the quarter versus 27% last year, reflecting higher wind conditions in the country, while abroad on average the load factor was 33%, coming from the low end of 26% in Germany and the very high end of 45% in Bulgaria. Anyway the operating results of ERG Renew kept remaining outstanding, with the EBITDA margin at 81%, farther up compared to 79% last year.

Moreover the company is going on with its plan to build up 80MW in Poland by the end of the year and also with its plan to complete the internalization of O&M activity expanding it to all the Italian assets, which surely benefit going forward for load availability, technical availability of the plant, but also in terms of absolute cost or relative cost in terms of megawatt.

Moving to Power, I have already commented the effect of the Mucchetti Decree: you can see here that the EBITDA is minus 23% year-on-year. This trend is expected to continue, as the Mucchetti Decree will remain in force, and the interconnection between Sicily and the Mainland should be at the end of 2015, according to the latest news coming from Terna, so with a six-month delay compared to the previous guidance.

You see also that volumes were up 2% notwithstanding that the plant started up its general turnaround on March 16, therefore effecting the production in the month of March. This was due also to the new rules of the Mucchetti Decree which entails a higher minimum technical level for the plant.

I have already commented the main effects: lower dispatching revenues, lower modulation revenues, lower premium in Sicily, lower prices of energy partly offset by the expected reimbursement according to the Delibera of the Authority.

Coming to slide no. 11, you see that the CAPEX for the quarter was €13mn, roughly 90% concentrated in the Wind. Wind means taking on with the investments to bring the 80MW - but in particular in this quarter the 42MW which were started up last year - in Poland.

During the quarter, we also bought two projects for total of 38MW. So to this €13mn invested as CAPEX you have to add €7mn, which is the cost of these two projects and the relative building permit for a total of €20mn spent in Q1, which will be more evident in the cash flow statement.

Going on to slide no. 12, here for sake of continuity we are providing you with all the information you were used to see about TotalErg, i.e. the EBITDA, the breakdown between Marketing and Refining, the net profit which is the only figures which enter in our profit and loss in the line “income from equity investment”. But here you have all the elements to build up your models. You see that the EBITDA was significantly up year-on-year: €22mn against €4mn last year.

All the segments improved substantially: Marketing was €10mn higher than last year notwithstanding the scenario, which was still negative. You can see – to the left side of the upper half of the chart - the volumes in the industry were still down 0.6%, but on a backdrop of a very tough competitive landscape, with white pumps gaining market share and all the Majors loosing, particularly the incumbent as it is evident from this quarter results.

As far as quarterly results, you see that these effects were partly compensated by the scenario of the Refining, with indicator refining margins up almost $7/bbl, from minus $3/bbl to plus $4/bbl: this was a good help to the results. The improvements in margins probably reflects the collapse in the commodity prices. We are not expecting this effect to last for long, but anyway it was a good help for our quarterly results.

The improvement in Marketing has much to do with the actions taken by the company in order to reduce costs and to re-shape the retail network: just to give you a figure, the service stations at the end of the period were 2,700 roughly, i.e. more than almost 20% less than the outlets TotalErg had in 2012 (when we have announced the plan) and roughly 200 less than in 2014. So notwithstanding the lower margins in the industry, the improvement is quite clear. Fortunately, coming down to bottom line, you see the results - though improved - are still negative in absolute terms: 51% of this minus €6mn is going to be the figure you will see in our profit and loss.

Moving to key financials for the Group, I have already commented most of the lines: let me just comment the net financial expenses, which went up from minus €11mn to minus €15mn despite the average net financial position over the period was about €600mn, lower than last year. That is mostly related to the fact that risk free activity yields went down very, very considerably over the last 12 months, thus affecting the revenues from our cash management which is - as you know - more than €1bn. So the €335mn net financial positions is made of - on one side - €1.5bn of long-term net debt, which has a certain cost, while on the other side it is compensated by something like €1bn and more of liquidity, which has unfortunately low yield, in the region of 1%.

Anyway, results remain very positive also thanks to the tax rate, which went down to 29% also following the cancellation of the Robin Hood tax. Net profit at the end was €34mn, i.e. plus 15% year-on-year, which I think is a very, very good result.

Let us move to my last slide, regarding the cash flow statement. You see here that the deleverage of the company went on, with a minus €74mn reduction in terms of net debt, which at the end of the period was €335mn, €111mn cash from operation, €20mn of investment (i.e. €13mn plus € 7mn); I have already commented financial charges, and practically no taxes, as it is not the period to pay them.

In the end, the leverage of the Group was 16%, farther decreased compared to the 19% when adjusted for deconsolidation of TotalErg at the end of 2014. So now back to Luca for his final remarks.

Luca Bettonte:
Thanks. Thank you, Paolo. Now let me comment on our guidance for 2015 results. In this quarter we have seen a trend that shows good results in the Renewables and lower results in Power for the reasons that Paolo and I have already commented. Now, going forward for the rest of the year, we expect to post a €330mn EBITDA at year end. This number does not include the contribution of TotalErg, as we have deconsolidated it, and last time we met we said that the forecast for year-end was something lower than €400mn: the difference is just the contribution we expected to have from TotalErg, that today is no longer consolidated, that is the point.

As far as the remaining business let me remember further growth in Renewables and lower contribution from the Power compared to the last year. In terms of CAPEX, the guidance reflects mainly the investment we are making in Poland, with the three new plants that are going to be finalized by year-end. And finally you see the net financial position that is aiming at €530mn, starting from €335mn.

Here we have some specific items worth to be commented. Apart from the impact of EBITDA and CAPEX and of the €71mn dividends we are going to distribute this month, there are two relevant important impacts that are going to get this net financial position to grow: one is the payment of the taxation relating to the sale of ISAB Energy we made last year (the tax is going to be paid this year, and the amount is in the range of €90mn). While on the net working capital, we have two relevant effects: one is the payment of a trade payables to us and NIOC (so something from the past, from the old business, and whose amount is in the range of €45mn), and then the impact on the settlement mechanism relating to the amendment Mucchetti with reference to the amount that through this decree, the power plant has the right, is entitled to receive, and that is going to effect the net working capital dynamics, because this settlement is going to take placed next year (so during the first quarter of 2016), but the impact is to get this net working capital growing during the year. Those are the main reasons why we see our net financial position to go up from €335mn to €530mn at year-end.

So again good results and good indications for the year-end. In terms of business plan, of course the presentation of the business plan is linked to the effective outcome of the potential transaction related to the acquisition of the hydro plants from E.ON and its relevant timing. We finished, and I guess we are now ready to take your questions.

Questions & Answers

Operator:
This is the Chorus Call Conference operator, and we will now begin the questions and answers session. Anyone who wishes to ask a question may press “*” and “1” on their touchtone telephone. To remove yourself from the question queue, please press “*”and “2”. We kindly ask to use handsets when asking questions. The first question is from Roberto Letizia with Equita SIM. Please go ahead.

Roberto Letizia:
Yes, good morning. I have a question on the possible evolution of the business. I know you will give us all the details in the strategy plan, but can you let us know if there is anything more you are looking at in terms of geographical diversification (or asset diversification) that is attracting your interest in case you will not be able to get the E.ON plants in the coming weeks? Because the issue of the liquidity and the un-efficiency of the capital structure is becoming even more evident month-after-month, together with the fact that is not yielding anything currently, and you are currently trading very high multiples that would be deleveraged either through the increase of the dividend or the increase of the CAPEX. So can you just generally talk about this argument without entering of course in all the details, that will be probably discussed during the strategy presentation? Thanks.

Luca Bettonte:
All right. Yes, you are right, we are working on our business plan, I mean that the business plan has been already prepared inside the company, and of course we have already drawn its guidelines. For sure we are looking for further growth abroad, mainly through our wind arm, i.e. ERG Renew, and we are going to be more precise when we meet to share with you the business plan. It is quite clear and even more evident that we have a liquidity issue to deal with, that is the point.

Based on that, if you simply consider what you can get from the so-called public available information, so what you see on the newspapers, you see that the potential transaction with E.ON is quite relevant for us, both from an industrial diversification viewpoint and from a value viewpoint, because on the news you see that the value of this transaction may be in the range of €900mn/1bn, so if you compare this amount with our market capitalisation, you see it is quite relevant.

So we are quite interested, but this transaction is quite complicated as it involves people, involves assets, involves companies, involves permits and the like, and the decision made by E.ON to go through a break-up of their assets brings to us a very complicated transaction, and the timing for the business plan going forward - so from the next year going on - is quite linked to the outcome of this transaction.

Today, I am pretty convinced that we may be in a position to finalize the transaction. But based on the latest news you have got from the press, the situation is much more complicated than last time we met and I talked to you all about this potential transaction.

In any case the Group has a B plan in case we are not able to finalize the transaction, and then I would like to share with you this different view, that is in any case based on the guidance you already know: I mean the quality of assets we are going to invest, diversification abroad and growth in the Renewables. I think that the message we are sending to you all financial investors taking out TotalErg from our core business is a quite clear indication of the path we are going forward now.

Roberto Letizia:
So, I ask just a little bit more clarity on E.ON's level of complicacy of the transaction, but - as we do not have all the data - the easiest things I would have imagined for you is

using the liquidity in the very short term in order to avoid the loss of value (as it is not yielding anything), and raising the debt at this fantastic level that would lead you to a very cheap debt, and then make the acquisition using the debt that would have been resulted in maybe a much more balanced financial structure, unless E.ON deal takes some level of debt associated with it that does not permit you to use the cash right now through dividends, and then raise additional debt. Is there any complication of this type on the E.ON's deal?

Luca Bettonte:
Well, it has not to do with this angle of the transaction, because from a leverage viewpoint I think we are in a position also to look at the business we would like to buy that allows us to have a lot of flexibility on the way we can arrange the financing and the leverage on the business itself. So the complication with the transaction itself has to do with the breakdown made by E.ON, today E.ON is selling not just the hydro plants, but their solar and gas business to another company (EPH), and this inside an exit programs from Italy.

So I think, but I would not want to be in their shoes, that this is bringing to them a lot of difficulties in making a breakdown of the assets in the appropriate manner and in due course, this is the point. Of course as I told you there is a lot of activities to be done and there are also other complications deriving from the environmental investigation that you have read on the newspapers, that is bringing some delays in making decisions and finding agreements, this the point.

Roberto Letizia:
Okay. Thank you.

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

Paolo Citi:
Good afternoon. I have just one question related to the TotalErg debt, on which I was making some calculations. At 2014 year-end the debt of TotalErg was around €130mn, while at the end of March it was much higher, I think it is mainly related to the working capital evolution. My question is how much was it included in your previous guidance for 2015 year-end net debt that was around €650mn, if I remember well…

Paolo Merli:
Hi, Paolo. Yes, you are right. So the net debt of TotalErg is reported in slide no. 12. You see that at the end of 2014 it was in the region of €130mn. Our 51% quota was included in €538mn of net financial position at 2014 year-end. As you said, the increase at the end of March is related to working capital dynamics, which usually depress debt at the end of the year, while there is a reversal in the first quarter, as it was in 2014. As a matter of fact, the net financial position at March end at €456mn for 100% of TotalErg is pretty much in line with last year figure. In our guidance (which was previously €650mn), you can calculate, you can extrapolate €120mn as a simple difference, because we did not change our guidance, if adjusted for the difference in perimeter. So you can simple

assume that almost €120mn was the expected net financial position, our quota of TotalErg at the end of the year.

Paolo Citi:
Okay. So there is no change at all?

Paolo Merli:
Absolutely not.

Paolo Citi:
Okay, thanks.

Paolo Merli:
It is just the same.

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

Luca Bettonte:
Okay, fine. Thanks everybody for coming and hope to meet you as soon as possible.

Paolo Merli:
Thank you from me as well. Bye-bye.