EDP - Energias de Portugal
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Chaired by António Mexia

Company Participants

- **António Mexia, Chief Executive Officer**
- **Nuno Alves, Chief Financial Officer**
- **Miguel Viana, Head of Investor Relations**

Miguel Viana: Good morning ladies and gentlemen. First of all, thanks for being with us today in this conference call for the presentation of EDP's 2017 1Q results, this time with a tighter schedule between the timing of the results' release and this presentation.

As usual, we will begin with a presentation providing an overview of the results and the main developments during the period and afterwards, we will move on to the Q&A session, in which our CEO, António Mexia and our CFO, Nuno Alves, will be fully available to answer your questions. We'd like to highlight that this time we are only going to take questions submitted via the Web, so please ask your question only through our Web page, www.edp.pt. We expect that this call will last no more than 60 minutes.

Now I will give the floor to our CEO, António Mexia, who will give us an update on the main highlights of the period.

António Mexia: Hello, everybody. Good afternoon. Tipically in Europe. So, first of all, I would like to apologize for this change that we will go back to normal, having our presentations in the morning the following day to give you more time. But I really need to be tomorrow in Brussels. I am going to hand over my chairmanship of EURELECTRIC in June, and tomorrow is the last board before that handover. So, really, I need to apologize I need to be tomorrow in Brussels. So, I could not cope with those agendas. And I want really to be here to share with you my comments in this conference call.

So let's go through the first six slides then I will hand over to Miguel as usual, and then we'll go to the Q&A. So, I would like to start by highlighting the resilience of EDP business model in a quite challenging environment in this first quarter. This was characterized by being the driest first quarter of the year in the Iberian Peninsula over the last five years, resulting in a 54% reduction year-on-year in our hydro generation in Iberia when compared to the very rainy first quarter. Even in this tough environment, our recurrent

EBITDA showed a modest 5% decline to slightly above €1 billion, €1 billion and €11 million. We will then see in detail the different contribution of the different business units. At the level of net profit further declined on interest costs, in line with what we have been showing the last quarter, together with a positive impact from the Brazilian real appreciation, 29% year-on-year. And the decline in the effective tax rate fully in accordance with our guidance, resulted in a mere 1% decline of our recurrent net profit to €285 million.

Moving to net debt. We see that it remained mostly flat versus last quarter at €16 billion, despite a significant amount of investments related to the expansion of our wind capacity as it was as it was foreseen, and the absence of any material proceeds from tax equity investors, asset rotation deals or any other disposals in the quarter. As you will see, as you already know, the remaining of year, it will be very different.

As you know, we have recently announced a reshuffling of our business portfolio. The signing of definitive agreements for the disposal of gas distribution network in Spain and in Portugal to deal that we'll represent cash proceeds of around €3 billion and capital gains above €700 million. And moreover, on the March 27th, EDP made a preliminary announcement of a voluntary tender offer over the 22.5% free float of EDP Renováveis, enterprise of 6.8 per share, representing a 10.5% premium over the average share price in the previous six months.

Finally, on the April 19th, EDP Shareholders Meeting has approved an annual dividend increase of 3% to €0.19 per share that represents a 72% payout ratio on 2016 results. Inside the target payout range for the period and totally consistent with our sustainable dividend policy that is being a trademark. The dividend will be fully paid in cash in a single payment on the next May 17th with a corresponding ex-dividend date being the May 15th.

So, let's go through the EBITDA. Recurring EBITDA on slide 2 is 5% penalized by generation and supply in Iberia. Regarding EBITDA, we can see that excluding capital gain on the sale of Pantanal hydro plant in Brazil last year first quarter, recurring as I mentioned, EBITDA fell 5% including a 4% impact from forex due to the – what I'll refer depreciation of Brazilian real. In Iberia, EBITDA fell by 17%, including a 38% decline in generation and supply, penalized by the lower hydro and higher power pricing environment while EBITDA from regulated networks benefit from the new regulatory models for our electricity distribution in Spain and importantly, efficiency improvement.

Regarding EDP renewables, EBITDA year-on-year conversion was penalized by very windy first quarter last year, namely in Iberia, versus a normalized wind conditions this year.

So, let's go and dive a little bit more in detail into the hydro production on the slide 3. 36% below long-term average. We can see that this long – this significant difference below the average is also 45% above long-term average in the first quarter. And being even worse, then also in favourable hydro conditions in the first quarter 2015. As you remember, 2016 was very, very wet and 2015, dry, but it was even drier than in 2015 to 2017. As you can see EDP hydro production this first quarter fell by 54% versus first quarter and decreased 22% when compared to the same period in 2015 despite the new hydro capacity commission in between.

Nevertheless, the low risk profile of the company and our resilient business model allows us to achieve a compiled gross rates of EBITDA of 5% between first quarter 2015 base and first quarter 2017. And I think it's important to highlight it. This is still above our 3% target for the 2016-2020 period that we presented in the Investors Day in May 2016, which as you may remember was based on a weather normalized financial figures from 2015.

The CAGR of recurring net profit for the same period was 13%, clearly outperforming our medium-term growth target when using as a base purely comparable weak hydro conditions. So, 13% better than the 4% that we committed at in that moment. So, this trend I think it's meaningful.

On slide 4, 2017 is clearly a transition year towards a more simplified structure of the group. So, regarding the outlook for 2017, I will point out that given the ongoing portfolio reshuffling, I think it's important, this is clearly what we say the reason why I call this a transition year for EDP towards business structure simplification. The 2017 figures will be positively impacted by the one-offs from the significant disposals, and also some negative weather effect in the first part of the year. These one-offs and weather related impact will not affect financial performance in 2018 and following years and allow us to continue strongly confident that we will deliver a financial performance fully consistent with a target we established in our 2016-2020 plan as we have shown already.

Our regulated and long-term contract operations which will continue to present around 75% of our EBITDA post gas distribution disposal and post-mix final adjustment continue to perform fully in line with expectations.

So, overall, I would say that we have no reason to change our weather normalized and recurring net profit expectations versus what we commented in the previous conference call of results in last March. Also regarding the net impact from one-offs and weather related effects, it will be obviously very positive.

But let me also add that the year-on-year comparison in terms of hydro production will be much easier to beat in the second half of this year, given as you remember, the dry weather in the last quarter of last year with hydro production in Portugal 50% below long-term average. So, when we talk about the dry winter, it's started already last year. So clearly, last quarter was 50% below average. All in all, we are confident that recurring net profit in 2017, we will stand above 2016.

Finally, I would say that the current main uncertainty for 2017 is the final outcome of the current tender offer over EDPR which will obviously impact significantly the magnitude of our net debt risks. So, let's see. We will talk this after the game is over.

Slide 5. Let's talk about asset allocation strategy. As you can see, we continue focus, as we have been, on the delivery of our medium-term commitments. Our new hydro plants in Portugal and Brazil, we reached in 2017 the end of a long and intensive investment cycle with the full commissioning of the two last hydro plants under construction Foz Tua in Portugal by the summer, and São Manoel in Brazil by the end of the year.

Regarding wind, we have now 400 megawatts under construction and we have already secured more than two-thirds of our target of capacity additions for the 2016-2020 period. We are at 66% of that target, so we are ahead of the curve.

In what concerns our voluntary tender offer of EDPR. As it was explained by the time of its launching, it may allow EDP to address on a more competitive way the new trends in electricity value chain, namely regarding a closer integration of renewables, storage, smart grids, customers and this represents a maximum investment commitment of €1.3 billion to EDP fully consistent with the financial deleveraged targets of the company. When you see the proceeds and you see the use of funds we have clear difference. Here, we have been working with the stock market regulator CNVM in order to have the full prospectus available to the market on the due schedule.

Now, a word on Brazil. EDP Brazil was awarded last week with four concessions to build and operate electricity transmission lines in Brazil, representing a total investment of BRL 3 billion or at the current exchange rate more than €800 million, of which 95% is programmed to be deployed in 2019-2021 period. This project will be 80% funded by BNDES at very competitive funding conditions, and I expect it to generate really, returns on equity in the range of 12% to 14% clearly reinforcing EDP regulated and long-term profile post 2020 and opening a new avenue of growth for Brazil. Because as we have been talking grid is the bottleneck of the system in Brazil. And the low risk approach and high return, I think that represents exciting perspective for the next phase of business plan.

We have been balancing, of course, these growth investments with some capital recycling through the execution of the value accretive deals that we have been talking as it was a case of, of course, gas distribution in Spain and in Portugal. Taking advantage of the right time and the right appetite from the potential buyer which allowed us to execute in our perspective two very clear, very enhancing deals and, I think, differentiating EDP once again from the rest of the sector. Finally, EDP Group will continue exploring opportunities regarding asset rotation and partnerships at asset level, of which the recent agreements with CTG for the sale of 49% stake in a portfolio of wind farms in Portugal for around €200 million, is a good example. Overall, we expect to continue to deliver profitable growth strategy, consistent with our financial deleverage targets. So, the balance between growth and deleveraging is a key element.

So, in the last slide, before going with Miguel. We see EDP focus on enforcing a distinctive profile amongst European utility, with a clear visibility on growth, based on the strong knowhow we have so far accumulated. Being it in renewables with PPAs or feeding-in tariffs or in regulated electricity networks. As you know, in renewables we have been clear where we want to go in which markets and which conditions with visibility on the cash flows, and I believe also here we are slightly different from other players. This growth will continue to increase the value of our product with high quality assets in well diversified markets and with competitive technologies. This growth strategy continues being executed and the straight financial discipline, imposed by our financial deleverage objectives in order to preserve GDP low-risk profile and its success to competitive cost of funding as it has been the case until now in a very clear way.

Finally, those are our growth objectives and successful efficiency program are key to deliver on attractive results. This is important to promote a sustainable and steady deleveraging process while keeping sharing returns with our shareholders as we have been doing through an attractive and sustainable dividend policy with the 65% to 75% target payout, with the new floor, as you know 19% per share fully in cash. So, as usual, I will pass now to Miguel, the Head of IR, for a more detailed analysis of the first quarter, and then we will move to Q&A. Thank you. Now, Miguel, please.

Miguel Viana: Thank you, António. So, moving to page 8. We can see that level of EDP's global generation portfolio, installed capacity on average has increased by 6% over the last six months as a result of the commissioning of 0.7 gigawatts of wind, mostly in the U.S. and Mexico, and 0.7 gigawatts of hydro pumping in Portugal last January.

Hydro production fell by 8% as a result essentially of the referred reduction in hydro production, 54% in Iberia and 24% in Brazil and including also a sharp increase in terms of CCGT output in Iberia.

Moving to an overview of the Iberian electricity market in the first quarter 2017. We can see that demand went up 0.2% in the period. Hydro production fell by 50% and coal and gas production increased by 59%. Wind production was also down by 14%, with the wind resources in Portugal being in line with long-term average versus 16% of those long term average in the first quarter 2016. And I would highlight also the absence of net imports from France to Iberian Peninsula in the first quarter 2017. Overall, this has resulted in 81% increase in average pool price to €56 per megawatt hour.

Moreover, as you can see on slide 10, after the complex environment in the first quarter 2017, with a highlight on January 2017 regarding power prices of above €70, extreme dry weather with the hydro factor in Portugal of 0.36 megawatt hours. We see that following these difficult four months at the beginning of the year, we can see and expect a normalized weather for the remaining 2017, which show forward prices in the region of €50 per megawatt hour for the remaining quarters of 2017. Regarding EDP, our hedging strategy in energy markets for 2017 includes forward sales by an amount of 30 terawatts hour at an average price of €55 per megawatt hour, mostly hedged through residential and SMEs, with improved thermal spreads locked-in versus in line with 2016 fuel costs. Moreover, we maintain flexibility with CCGTs in short-term markets with room to explore short-term peak modulation or ancillary service's needs. In this environment, as we can see in page 11, the EBITDA in our generation and supply operations in Iberia fell by 41% year-on-year following the referred decline on hydro production by 54% which resulted in increase in terms of average sourcing cost by 76% with the decrease in the weight of hydro in the production mix from 62% in the first quarter 2016 to 33% in the first quarter 2017 and also obviously a sharp reduction on energy management results as a result of the environment in the quarter. Moving to regulated energy networks in Iberia. We can see that EBITDA went up by 13% with electricity distribution in Spain benefiting from positive impacts from new remuneration model and in electricity distribution in Portugal an increase in the return on RoRAB by 44 basis points to 6.8% following indexation to the Portuguese government bond yield moving average. There was also obviously a positive contribution from higher efficiency with controllable costs in our regulated networks in Iberia going down by 3% year-on-year.

Regarding EDP Renováveis in page 13, we can see that EBITDA went down by 2% despite the 8% increase in terms of average portfolio of installed capacity, offset by the normalization of wind resources from 7% above long-term average to just 1% above long-term average in the first quarter 2017 and also including a 2% positive forex impact from depreciation of U.S. dollar versus the euro.

Moving to EDP Brazil, EBITDA on a recurrent basis excluding the capital gain on the Pantanal disposal in the first quarter 2016 went up by 3%. This 3% results from a 52% increase in terms of EBITDA and distribution following an increase in terms of regulated revenues and lower negative impact from overcontracting and 22% increase in EBITDA from hydro generation and supply, following a strong performance in the first quarter 2017, which should be diluted over the full year following GSF forecast to go down to around 85% the full year and a decline in terms of the EBITDA from Pecém by 52% as the first quarter 2016 figures are impacted by BRL 82 million insurance compensation revenue and first quarter 2017 was penalized by an increase in spot prices in Brazil.

Regarding operating costs, they are increased by 2% in Iberia, following a 6% increase in terms of average megawatts in operation. 1% increase in terms of average number of customers, 60% increase in terms of thermal production which obviously implies higher operating cost and also comparing comparable inflation in Portugal of 1.4% for the period. At level of EDPR, core OpEx over megawatts went down by 1% following an increase of OpEx ex-forex impact by 6% and the 8% increase in terms of average installed capacity. Finally, Brazil OpEx in local currency inflation adjusted, went up by 1% as the OpEx in local currency increased by 6% above the 4.9% local inflation. Overall, our OpEx for corporate wide efficiency program resulted in €34 million savings in the first quarter 2017, 21% above the target in the plan.

Moving to Portugal electricity system. We continue on track to surplus around €0.5 billion in 2017. In the first quarter 2017, we have reached €66 million tariff surplus which compares with the €59 million tariff deficit in the first quarter 2016.

Moving to page 17. We can see that at EDP balance sheet level, regulatory receivables reached a nine-year bottom at €0.7 billion, decreasing by €0.3 billion in Portugal including €0.6 billion positive impact from the sales without resource in the first quarter 2017 of some tariff deficit. While in Brazil, we showed €0.1 billion of regulatory payables by March 2017 on lower than expected sourcing costs to be reverted in following quarters.

In terms of adjusted net expansion investments, significant year-on-year increase of €0.7 billion is explained by a slight increase – a slight reduction of expansion CapEx with new hydro plants in Portugal reaching full completion, a stable change of equipment suppliers following the normal seasonal first quarter effect at EDPR level post the fourth quarter commissioning of new wind farms. The change in consolidation perimeter includes in the first quarter 2017 the full consolidation of the 200 megawatts Mexico wind farm. And the absence in the first quarter 2017 of any material divestment or tax equity investments proceeds versus €0.5 billion on these items in the first quarter 2016.

Going forward, I would recall first of course the €3 billion expected proceeds from the disposals of gas distribution in Iberia. €0.2 billion expected proceeds from the wind portfolio minority stake in Portugal. All with financial closing expected between late second quarter and beginning of third quarter 2017. Also in terms of tax equity investor proceeds from 2017 projects, they are expected this year to come by late of the year and as it was referred regarding expansion in hydro, we expect the full completion still this year of the two hydro plants still under construction.

Regarding net debt. It remained almost flat following at level of free cash flow excluding regulatory receivables. A positive impact of €0.4 billion. A positive impact also in terms of debt reduction of €0.3 billion from lower regulatory receivables as it was already referred. And also the previous referred €0.7 billion regarding adjusted net expansion investments in the first quarter 2017.

In first quarter 2017, we have a €0.2 billion negative impact on net debt related to VAT one-off payment, which will be refundable still this year in 2017. There was no material forex impact this year neither as the currencies of real and the dollar were in line in March versus December 2016.

On page 20, regarding financial debt profile by currency and maturity. We maintained our natural hedge policy with investments and operations funded in local currency to mitigate forex risk. While average debt maturity was slightly decreased from 5 years in December 2016 to 4.9 years by March 2017.

Moving to financial liquidity. By March 2016, we had €5.6 billion of which €1.6 billion are relative to cash and €4 billion relative to available credit lines which cover our refinancing needs beyond 2018.

On page 22, we can see that net interest costs continue to show a clear downward trend going down by 13% year-on-year following a 7% decline in terms of average net debt and a 20 basis points decline in terms of average cost of debt from 4.5% to 4.3% in the first quarter, reflecting obviously our steady deleveraging process and marginal cost of debt clearly below our average cost of debt.

On page 23, at the level of financial results, overall and excluding one-offs in the first quarter 2016 related with the gain on the sale of Tejo Energia, you can see that the lower interest costs were offset by lower financial revenues namely the ones that our regulatory receivables related following the 75% decline on balance sheet and lower returns but also lower capitalized interest on the commissioning of Venda Nova III in January and also higher costs with tax equity investors in U.S. wind operations and obviously also more adverse forex results.

Overall, when we exclude one-offs, we can see that the net profit decline of 18% from €263 million to €215 million results in a recurring net profit decline of 1% from €287 million to €285 million in the first quarter 2017. We'll move just after a small interruption to the Q&A session. Thank you very much.

Q&A

Operator: Thank you. Ladies and gentlemen, we'll move into the Q&A. Ladies and gentlemen, your conference will now resume.

Miguel Viana: Hi. Thanks, everybody, for waiting. So, we'll start with the several questions on guidance. We have questions about guidance for 2017. The results from Carolina Dores, Morgan Stanley; Jorge Guimarães, Haitong; Manuel Palomo; Exane BNP; and Antonella Bianchessi from Citi.

António Mexia: So, let's see. By the way, the basic concept of recurring net income. It's very simple. It excludes only the impact of asset disposals. It's the reason why we compared with last year as it was the sale of Pantanal. So, we exclude the one-offs impact when we do asset sales. So, it includes everything that relates to climate and difference, whatever. So, it's only asset disposals and sales. It's the only thing that if exclude it from the net income in terms of recurring. So, the rest of business is there.

So, let's talk about guidance. We are talking about guidance for the net income. We prefer to talk about these and guidance of EBITDA. Why? Because EBITDA depends very much on the moment of the exit of – so it means the financial closing of the deals that we have been talking about, the disposals of the gas. So, it makes much more sense to think about net income. And what – why do we see above – 2017 above 2016 in spite of the first quarter? If we assume the second half of the year at the average weather, we expect to recoup on a comparable basis, enough to have higher than €919 million. This includes the asset reshuffling transaction impact on both dilution and accretion.

As I mentioned in the introduction, the second year – second half of the year is very easy to beat. Why? Because 2016 was very weak. So, comparison 2017 with 2016 will be probably very easy. So, we prefer to refer always to the €919 million some of you have already mentioned the €996 million that you see there as a theoretical consensus, but it's important to mention that this figure of €996 million, we have already two analysts that includes already the impact of €700 million of the disposals. So, I would say that that figure is already polluted. And so, it already mixes apple and pear. So, when we refer to like-for-like, we should compare with the €919 million. In what concerns, I think, it's all this first question.

Miguel Viana: Okay. Maybe we can go to the second question. We have question also from Carolina Dores from Morgan Stanley regarding Brazil. So, how much earnings accretion do you expect at EDP Brazil level once the new transmission lines in Brazil are commissioning?

António Mexia: So, as we have mentioned, these are supposed to be ready between 2019 and 2021 and IRR are between 11.5% and 14% in real terms. I would like to mention that all the agreements that we need to deliver the construction and all the project were already negotiated with firm commitments by the suppliers. So, it's not a theoretical return. And, as I mentioned, we recognized transmission today has been less risky with better returns than distribution in Brazil, especially because with certain uncertainties that still exists in distribution, namely the overcontracting that by the way, has been positive this year, but represents a problem in a normalized year So, with these returns, everything locked up in what concerns development costs and all the analogies made, we feel that it's clearly a creative starting already in 2019. The third question is?

Miguel Viana: So we can go to third question from Andreas Müller from Credit Suisse Would you consider refinancing your 2017 maturities with new hybrid bonds or will you just redeem the bond through the cash flow from the asset reshuffling.

António Mexia: This is Nuno. Thank you for the question, Andreas. Our view today is that clearly, the asset reshuffle will improve the credit metrics of EDP and hence, the path to improve ratings exists just by organically. So, we don't feel the need to issue any new hybrid bonds, given the fact that the view is positive and we would expect to see in the future upgrades to our rating. And as far as what we will do with the cash, clearly, it will be equated the possibility of some liability management again. But until we know how much we collect, it's a little bit too soon. But clearly, we'll end up with too much cash, so you probably should expect some acquisition of the bonds going forward, but we'll see how it goes.

Miguel Viana: So, we have also questions from Carolina Dores. If EDPR offer is not successful, do you plan to pay down debt and keep the leverage down low? Or is there a plan B in terms of investments?...

António Mexia: So, we expect the full registration to occur in, I would say, one, two weeks if everything goes normal. And then I would not like to define what is successful or not. Carolina, I like your question, but I will answer this after we see exactly the final results. So, I apologize, but clearly as you can always have in your mind, we have been in all these movements, in all these asset allocation, asset reshuffling, we have been clear we have kept the balance between growth and deleveraging, totally committed with this deleveraging towards three times in 2020 and the credibility of our dividend policy in terms of returning earnings. So, you will not be surprised by the final outcome, I believe.

Miguel Viana: So, we can go to the next question from Jorge Guimarães, Haitong. Is it possible to provide breakdown of EBITDA in Iberia in generation in the old reporting CMEC/liberalized[indiscernible] So, I would answer this one.

So, we are integrating this time given that this year, as you know, we had only six months of CMEC. And so we are integrating the reporting. So, doesn't make much sense to look to annual results in terms of 2017 in terms of the breakdown with CMECs. Nevertheless, we provide the amount in terms of gross profit which is the CMEC compensation the first part which is correct. And we'll continue to provide this only, hydro, yes, we have only hydro at level of coal. There was no reason to any compensation in this first quarter 2017, and we will report for the last time in the second quarter 2017.

The next question also is from Jorge Guimarães, Haitong. Regarding OpEx and distribution, do you expect OpEx evolution in Portugal electricity distribution to be maintained in 2017, so regarding the OpEx and distribution?

António Mexia: Yes. Here, the answer is very easy and very quick. Yes, we will go on with this effort. And you see since the OpEx one including distribution that we have been always ahead of the curve. In OpEx for last year, it was already the case. In this quarter, we are already 21% of our target. So, if anything, we will always end at the moves of different releases of the lower costs typically with the one year in advance for each program. So, yes, the pressure will be there for obvious reasons. You need to do what you need to do and being already above 21% it doesn't mean that we will not be putting additional pressure in all the business units including distribution.

Miguel Viana: We have here also some questions from Stefano Bezzato from Credit Suisse and also from Javier Garrido, JPMorgan regarding the inclusion of the energy tax on the recurring net profit and also regarding what is the expectation in terms average tax rates, effective tax rate for the full year 2017?

Nuno Alves: Okay. And as far as I mentioned this – António mentioned this at the beginning. The sales, the extraordinary tax is considered an extraordinary. So we've been considering it an extraordinary in the past. The €919 million EBITDA is an extraordinary and we will continue to do so this year. So, we're comparing apples-with-apples. And as far as the tax rate for this year, our expectation is that will be below 20% by year-end.

Miguel Viana: We have also a question from Javier Garrido from JPMorgan regarding gas. What is the magnitude of recurring net income growth you are expecting – so, this one we have already answered. That is regarding natural gas EBITDA growth restored LPG assets. So how much did LPG contribute to the first quarter?

Nuno Alves: Especially the first quarter natural gas EBITDA goes up by roughly €9 million. €4 million are from LPG assets. The other €5 million are corrections for 2016 numbers.

Miguel Viana: So, I think we don't have any more questions in the web. So, we have some from Bank of America Merrill Lynch and from BBVA that we will answer at IR level.

I will pass now to our CEO for final remarks.

António Mexia: So, thank you for being present. I think that we have been clear in what concerns of our guidance, our vision of 2017. We have been analyzing what is the moving parts of the business but we are also clear in what concerns of the next months being active on the financial closing of the disposals and also on the side of the EDPR bid. So, we will meet again soon. And thank you once again for being with us, sharing this first quarter resilient results in a challenging environment. We have been doing what we need to do basically. Thank you very much. See you soon.

Operator: Thank you, ladies and gentlemen, that does conclude your conference for today. Thank you all for participating. You may all disconnect.