EDP - Energias de Portugal
Wednesday, 28th July 2017
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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**

Operator

Ladies and gentlemen, thank you for standing by and welcome to EDP's 2017 Second Quarter Results Webcast. During the presentation, we will have a question-and-answer session and you can submit questions any time via the webcast. I must advise the webcast is being recorded today on Friday 28 of July 2017. And now I'd like to pass the webcast over to your speaker today, António Mexia. Please go ahead, sir.

Miguel Viana: Good morning, here is Miguel Viana from the IR team. First of all, thanks for being with us today in this conference call for the presentation of EDP’s 2017 1H results.

As usual, we will begin with a presentation providing an overview of the results and the main developments during the period. And afterwards, we'll 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.

I would like to highlight that like in the previous quarters we are taking questions submitted via the web. So, please, if you want right now to start asking your questions, you can do it through the web, www.edp.pt. We expect 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: So, good morning, everybody. Thank you, Miguel. Thank you much for participating in this results conference call. We are at the end of this week, the end of

July, everybody wants to probably have plans for the next week. So thank you for being in this conference call.

First of all, it's worth highlight, we start with slide 1, the continued resilience of EDP business model in a very adverse environment, namely for hydro production in Iberia in the first half of 2017. We have already talked about this in the first quarter. That is of course the most important in the year. Our recurring EBITDA showed a moderate 5% decline to €1.9 billion in spite of the 62% year-on-year reduction in our hydro production in Iberia. And especially, we need to compare this year where the resources were 42% below the long-term average compared to last year's 68% premium to the average.

When we walk down to net profit, the good performance of financial result stands out with a 40-basis point year-on-year decline in the average cost of debt from 4.5% in the first half of last year to 4.1% in the first half of 2017.

Then our OpEx program is always something that we like to focus, what we call the OpEx IV. The profit efficient program is well on schedule with slightly more than €70 million of savings achieved in the first half, 27% above the target.

And what concerns net debt, it stood at €16.9 billion, reflecting the full cash payment of the 2016 annual dividend in May amounting to €700 million and the cash-out of $600 million in non-recurring tax payments, half of it related to abnormally high level of term securitization last year. By the way, I think it was a very successful year in what concerns securitization. And the other half, due to the VAT payment associated to some internal restructuring, which is expected to be refunded in the second half of this year. While in 2016, disposals and asset rotation deals were mostly front-loaded in the first half of the year with the capital of very important wind farm assets rotation deals

In 2017, cash proceeds from disposal are concentrated in the second half with a sizeable contribution from the disposal of natural gas. Closed this week, as you know, we have announced this yesterday, and Portgas expected to be concluded still in the first quarter. Together, these deals should represent a total cash proceed of €2.8 billion in third quarter 2017, providing a significant contribution to the reduction of our debt.

Finally, the acceptance period of our tender offer of the EDPR at €6.75 per share will end up by the end of next week. By August 4, we will have clear visibility on the exact impact of the net debt from the combined deals of natural gas disposal plus the tender offer of EDPR.

So, let's move to slide 2. As I refer, the first half was marked by adverse weather conditions regarding hydro production, something that we all knew since the beginning of the year. On a quarterly basis, in the second quarter of this year, hydro production was even slightly lower versus historical average in the first of the year. While the year-on-year – conversion days on the year-on-year was even more challenging given the particular strong hydro volumes in the second quarter last year. Overall, sale for the period for the first half of 2017, our hydro production was down 7.8 terawatt hours and around 4.5 terawatt hours lower than average historical average.

Note that the second half of the year, and I think it's important as we speak, which includes the seasonal dry summer season is structurally less relevant for hydro volumes than the first half of the year. And on top of this, in year-on-year

terms, the first quarter last year was very, very dry, so it's a much easy comparison base. So, overall, although our first half recurring performance was significantly penalized by low hydro, this is a short-term weather impact which does not affect our recurring EBITDA forecast forward.

So, slide 3, recurring EBITDA. Focusing on EBITDA, we can see that excluding one-offs, the recurring EBITDA in first half fell, as I already referred, by 5%. EBITDA in the first half includes a 3% positive impact from forex, mostly due to the 20% depreciation of the Brazilian real versus the euro. In line with this, EBITDA from EDP Brazil advanced by 31% year-on-year.

In Iberia, EBITDA fell by 22%, including of course the 43% decline in Generation & Supply penalized over the stress by the low hydro and higher power prices environment. In turn, EBITDA from regulated network advanced by 3% on tight cost control. EDPR EBITDA rose by 11% year-on-year mainly supported by portfolio new capacity additions in U.S. and Mexico.

In slide 4, I think it's a relevant one also. Interest costs continued to show a clear downward trend on a quarterly basis, decreasing by 14% in the first half, marked by a 40-basis point decline in our average cost of debt to 4.1%, which is already below the 4.2% target average cost assumed in our business plan for the 2018-2020 period.

As we can see in the right side chart, we have been able to access the credit market for longer tenure and that's at very competitive prices, which are significantly below our average cost of debt. As an example, the $1 billion U.S. dollars bond issue carried out in June was the cheapest ever in this currency more than twice of subscribed, which indicates the appealing credit profile of the company.

If we move to slide 4, outlook for 2017; I would point that given the ongoing portfolio shuffling, this is a transition year for EDP towards business structure simplification. We have already stated this previously when we announced the deals. And then 2017 financials will be positively impacted by one-offs from the significant disposals and also some negative weather effect in the first half of the year. These one-offs and weather-related impact will not impact financial performance in the following years and allow us, as we speak, to continue highly confident that we will deliver financial performance fully consistent with the targets established in our 2016-2020 plan.

In terms of recurring EBITDA, the negative impacts from weak hydro volumes in Iberia in the first half and the deconsolidation of the gas network in the second half, coupled with the positive impact from higher wind and hydro installed capacity and efficiency improvements should lead to an EBITDA in the region of €3.6 billion.

All in all, we are confident that recurring net profit in 2017 will stand above 2016, supported by the steady decline in the average cost of debt, which means that we reaffirm our guidance and outlook for 2017 versus what we commented in the previous conference call results last night.

Finally, the exact magnitude of debt reduction is dependent on the final outcome of the current tender of EDPR. But, in any scenario, we will see a feasible debt reduction based on different elements. First, the €2.8 billion cash proceeds to be received from gas disposal in the third quarter as I mentioned; €300 million proceeds from the tax equity deal recently closed by EDPR; the organic cash flow in the second half; and the expected €300 million VAT refund before the year end.

So, moving to slide 7, regulatory and legal agenda. In terms of regulatory developments, three themes stand out. First: the CMEC final adjustment. The regulator is working on its calculation, which is clearly defined by law and contracts and is essentially based on historical data. From our side, what you can expect is EDP to fully comply with the existing contracts.

Second: regarding the new regulatory period in distribution. The process is already ongoing and the public audition was held on the 22nd of June, during which ERSE proposed the extension of the new regulatory period from three to four years. Until October 15, the regulators should release the draft on the 2018 regulated revenues and regulatory parameters for the following years.

We believe that in terms of return on RAB, Portugal is in a very different situation when comparing to other European countries, given that today the premium between return on RAB and 10-year sovereign bond continues to be among the lowest in Europe. From the starting point, it is already very different from others and I think it's relevant when we anticipate what's going on, on this front.

Third: finally, on the CMEC judicial investigation, I would like to highlight that EDP's providing total cooperation and full information access to the authorities. As you know, EDP culture is to focus on value creation through transparent business process, by the way, it's recognized by all the indexes, which we apply across the several regulatory and competitive environments we are present due to our geographic and business diversification.

Slide 8: main growth projects. In terms of our growth strategy, we remain faithful to our focus on renewables, mostly in the U.S. and of course regulated electricity networks. The renewables capacity additions are well on track with 600 megawatts under construction and 70% of the 3.5 giga planned and announced for the 2016-2020 already built or secured.

Moreover, I would like to stress that we recently opened a new avenue of growth in Brazil through the award of concessions to build and operate five transmission lines in the country, representing a total investment of BRL 3 billion, but at the current exchange rate, it is close to €800 million. These represent the interests of EDP in a new regulated business segment with high visibility on the revenues in a country where we have a have longstanding experience of proven track record on delivery of new projects.

So, going to slide 9 and highlighting something that we like to stress the management: distinct portfolio of assets. This growth strategy allows us to continue reinforcing our distinct portfolio of assets, which has clearly one of the longest average residual life among the European utilities, and especially, lowest exposure to environment risk, thanks to the high share of renewals. Indeed, over the last years, we have been maintaining a clear visibility on growth based on what we know better and what we have been delivered, which is long-term contractor renewals and regulated electricity network that will represent around 75%, as we have been saying for the last two years, we will reach this ratio by 2020.

The high quality of our assets coupled with our presence in diversified markets has the foundation of our residual life performance even under harsh already conditions, so diversifying, behaving like a utility and diversifying risk, I think, it is important.

In what concerns also to slide 5 – sorry, I passed that, the tender offer of EDPR. As you know, we have four days left regarding EDP tender offer. It's important to remind that, as of today, there are four business days left for the end of the period. On August 4, will be held Euronext special regulated market session by Euronext Lisbon for determining and releasing the result of the offer. The time of the session is still to be stipulated and published by Euronext.

At this stage, I would also like to highlight that the offering is voluntary and this effectiveness is not subject to the fulfilment of any condition. In case, EDP holds more than 90% of the voting rights as a consequence of the offer, EDP may request a delisting of EDPR shares from Euronext by Euronext Lisbon by that date. And in that case, EDP will be able to maintain a permanent order at the price of €6.75 for a maximum term of three to six months. However, the exact time for this is not defined yet. This we'll be probably talking this on the Q&A.

So, thank you. And now, Miguel, please.

Miguel Viana: Thank you, António. So, moving now to the performance in terms of Iberian market in the slide 11, we can see that electricity demand went up by 1%, while the hydro production went down by 59% and wind production went down also 12%, what was compensated by the increase by 76% of thermal production and also by 3 TWh of net imports from France. This market environment resulted on a 70% increase of average pool price to €51 per megawatt hour.

Looking to EDP's electric production in Iberia, it went down by 14% year-over-year with a strong decline in the weight of hydro on production mix to 28% in first half 2017 versus 64% in first half 2016. This was the main reason for the fact that average production cost more than doubled given that thermal power plants had much higher production cost.

Moving to slide 13, we can see that Generation & Supply Iberia EBITDA declined by 24% as a result of what we referred before, essentially the decline in the weight of hydro in the general mix, but also the part of energy management with results being penalized by the high pool prices.

On page 14, regarding EBITDA in regulated energy network in Iberia; it increased by 3% with electricity in Portugal benefiting from slight year-on-year increase of return on RAB and after a 3% reduction on controllable costs and electricity in Spain impacted by tight cost control and by the reversal of a €6 million provision from previous year.

Moving to EDP Renováveis, which represented 38% of our EBITDA in the first half of the year, both end of period and average installed capacity increased by 8% mostly due to new capacity in United States and Mexico, and we have by June 2017, more than 0.6 gigawatt under construction mostly in U.S. Our production rose by 9%, supported by the referred increase of average capacity and also by wind resources in line with long-term average.

Regarding EBITDA at level of EDPR, it has increased by 11%. Following in North America, EBITDA growth of 32% with a positive impact from forex, 21% increase of production and also an increase in terms of revenues from tax equity investors and production tax credits and also a $6 million one-off in the first half 2017.

In Iberia, EBITDA went down by 7%, following a 9% reduction in production. This distinct performance in both Iberian countries, EBITDA in Spain plus 1% supported by an average selling price 12% higher, while in Portugal EBITDA went down 14% with average selling price at more 1%.

Regarding other markets, EBITDA went up by 2% supported by the EBITDA dilution in rest of European markets. Finally, in Brazil, our EBITDA excluding non-recurring items went up by 9% in local currency, reflecting in distribution, a strong growth in regulated revenues and also gains on the sale of energy surplus, export prices in the first half of 2017 versus loss in the first half 2016.

Hydro, also with a good performance, with a 30% increase in EBITDA following contracted sales front-loaded in the first half of the year and an effect that should be diluted in the second half, given that GSF was 97% in the first half of the year. But it is expected to be at 85% for the full year.

And finally, Pecém EBITDA which went down by 45% essentially penalized by a one-off revenue last year on insurance compensation and also with some penalization from high spot price, higher PLD price in the first half 2017.

Regarding operating costs, we showed a strong performance in the main front. In Iberia, OpEx increased by 1%, reflecting a 6% increase in terms of average installed capacity generation and also a 6% increase in terms of number of contracts with our customers, so a good performance versus the increase of activity.

At level of EDPR, our key indicator, core OpEx per megawatt, excluding forex was flat year-on-year as the average installed capacity increased 8% was fully in line with increase of OpEx ex forex. And finally, at level of EDP Brasil, OpEx in local currency and inflation adjusted was also flat year-on-year as the increase of OpEx was fully in line with local inflation of 3% in the first half of the year.

Overall, our OpEx for corporate-wide efficiency program achieved €71 million of savings in the first half of this year, 27% above the target assumed in our business plan.

Move to Portugal electric system depth; we can see that we continue on track for a two-year surplus in 2017 with a tariff surplus recorded in the first half of the year by €42 million versus a tariff deficit of €85 million in the first half of 2016. At EDP's balance sheet level, regulatory receivables were essentially flat year-to-date at €1.08 billion in June 2017 versus €1 billion in December 2016.

In terms of adjusted net expansion investments, they have increased significantly year-on-year following essentially the full consolidation of Mexico wind farm from January 2017 onwards. Also, the front load in 2006 namely in the first half of the year regarding disposals with the sale of mini-hydros in Brazil and two asset rotation deals at EDPR, while, as you know, in the first half of 2017, the amount of disposal was much lower. So we are talking essentially on the sale of 49% stake in some wind farms in Portugal and the sale of our 3.5% stake in Iran.

And finally, regarding tax equity investors proceeds, these deals and these proceeds are normally concentrated in the fourth quarter of the year. Nevertheless, in 2016, in the first quarter of 2016 more precisely, given some delay in terms of the cash proceeds of the 2015 project in U.S., exceptionally, we had €212 million cash proceeds in the first half of 2016. For the second half of 2017, as we know, we have announced yesterday the cash proceeds and the closing of Naturgas. And we continue to expect the closing of Portgas still in the third quarter of 2017.

On top of that, we have also announced this month the closing of the deals regarding tax equity investments for 2017, which we expect to close also during the second half of the year.

Regarding change in net debt during this first half, net debt which has almost increased by almost €1 billion in the year-to-date. This evolution reflects €0.6 billion of one-off negative items, essentially at the tax level. We are including here €0.3 billion of VAT payments made in this first half, which will be refundable during the second half of the year, so with zero impact in terms of full year numbers. And also, we are including €0.3 billion of income tax paid in May 2017, but fully related with the proceeds in 2016 regarding tariff securitization in Portugal which were at a very high level, as you know, last year.

Regarding free cash flow organic free cash flow excluding regulatory receivables, there was an increase of €0.2 billion from €0.6 billion last year to €0.8 billion this year. Regarding regulatory receivables, obviously, a very positive evolution last year and this year, we have even a slight increase in the balance sheet of EDP as we have already referred.

We have also – the already referred significantly more adjusted net expansion investment. The dividend payment was the full annual dividend payment, which occurs every year in the second quarter and a positive forex impact in this first half of the year, which reflects the weaker dollar and the real during the second quarter of the year. Overall, a strong free cash flow generation in the first half offset by some one-offs in taxes, so €0.6 billion and also the higher net expansion investments.

On slide 22, regarding financial debt profile by currency and maturity, we maintain the natural hedging policy, so investments on operations funded in local currency to mitigate forex risk, while average net debt stood at 4.6 years by June 2017.

Moving to slide 23, financial liquidity stood at €5.8 billion by June, so this week, we had a significant increase in this amount. Obviously, this €5.8 billion, which include €2 billion of cash and €3.8 billion of available credit lines and namely includes the revolving credit facility that matures in June 2019, they fully cover all the refinancing needs beyond 2018.

Regarding financial results, I would say that the net financial costs decreased slightly as the lower interest costs, so by 14% were partially offset by the lower financial revenues, namely lower revenues related with regulatory receivables and lower financial revenues on capitalized interest, while at forex, we saw a €16 million loss in the first half of 2017 versus the €5 million gained in the first half 2016. Also in terms of one-off, the first half 2017 numbers include €25 million from the gain on the sale of the equity stake in REN.

Finally, moving to net profit breakdown, we can see that recurring and reported net profit both went down by 5% as lower EBIT was partially mitigated by better financial results and lower effective tax rate.

We'll have now a small technical pause between one and two minutes, after which we can move to Q&A. So, thank you very much.

Q&A

António Mexia: thank you. Let's go for the Q&A. I would like to start by the guidance. We have questions related to the guidance from Rui Dias, Carolina Dores from Morgan Stanley, José Soares from JB, Jorge Guimarães from Haitong, and Pablo Cuadrado from HSBC. Here, I would really want to be clear in what concerns the fact that we expect the €3.6 billion EBITDA. And once again, begin above the recurring – last year, as you know, it was €919 million.

This, of course, based on the reasons that I've already stressed, based on a normalized second half, in terms of weather. And as I stressed already in the first presentation, when you compare to last year, if anything last year was already very dry, so typically, we see ourselves in line in terms of EBITDA for Generation & Supply. And by way, it already includes Brazil in hydro and price evolution because it some of you also asked this. So, it's already factor in what we have already – as these changes in prices and volumes in Brazil.

In what concerns the guidance for our debt, and then Nuno can talk a little bit about this, but it depends clearly on the EDPR outcome that I think that we should like to stress that in this asset reshuffling, we have been able to assure on time clear with full visibility now because yesterday was the big chunk the revenue stream, so what is coming in, and we still now have to understand exactly how to deal what is getting out and what's concerns EDPR deal.

Probably, also to EDPR deal, we have a question from Jorge Guimarães. As you know, we don't exclude any alternatives in terms of actions. We wanted to be very transparent that there exist alternatives if we are below the 90%. That I want to be very clear, nobody should expect anything in the short and medium term when we talk about these alternatives. All the mergers or whatever, I don't – we have not studied this, because of transparency sake we have included, because we like to include alternatives. We have not decided; we feel very comfortable with any outcome. It was an offer without conditions and people should not expect any action in the case we don't reach the 90%.

So what concerns the evolution of the Iberian markets from Rui Dias and Carolina Dores. The next quarter, as I mentioned, we expect normalization. We cannot expect anything else, rain is rain. As you know, it's still a little bit early because the hedging is mainly done in September-October. For the future for 2018 including, of course, the fact that we will have more renewals than was foreseen, we expect slightly below the price slightly below the business plan.

But in terms of what is critical in terms of spreads, this will be established in September-October and that this, as we speak, we don't see any change in what concerns our expectations and what we have been announcing until now to you. In what concerns Brazil, Carolina and Pablo have been asking about the M&As and everything, alternatives.

Let's be clear, there have been a lot of talk about the state owned companies need to deleverage, to sell, there will be a lot of opportunities, so a lot of things in the market. I want to be very clear on this point. We will not do anything that is out of our scale and especially nothing that will change our commitment in terms of deleveraging activity. So I want to repeat this again and again.

In Brazil, we have been, I believe, very smart. We're doing things on transmission lines with very good returns that, by the way, will give us visibility on cash flows at a level that compares to what we have now basically sold with natural gas at the end of the investment just of this last auction. But we will not do anything that will change the ratios of the mother company.

In what concerns – on the order of what went in, the CMECs, Guimarães from Haitong and Rui Dias from UBS, and the regulatory review. Things are in the final CMECs. This will be done at the same – dealt at the same time. So we expect in terms of, dates final September. So things need to be incorporated for the proposal of the regulator and what's next year – tariff – regulated tariffs on October 15.

As we speak, I feel comfortable in the sense that, on the distribution side, we have been mentioning we are already with lower spreads and it's relatively all over the place in

Europe, so I don't see a big change on that front. In what concerns the end of the CMECs, I will repeat again and again. It's based mainly on contracts, on historical data based on clear rules checked by, of course, ERSE, the independent regulator, and we – I think that everybody will respect contract. So, it's what it is and I don't change my view relating to what I said three months ago or six months ago or nine months ago.

In terms of consolidation in the sector, from José Soares from JB; I would like to say that we have clearly denied any conversations with anybody, so no need to repeat it again and again. We don't dwell on rumors and our only obligation, as always, is to defend the shareholders value, the shareholder interest.

So, let's be clear. No conversations and management obligations being fulfilled as It's normal. In what concerns, wind in France, there was also a question. As you know, the deal was delayed by a question between Gamesa and Siemens and we expect the final decision to be taken towards the end of 2018. We have been working and the project that now looks better than eventually at the moment we have taken the preliminary decision because of the evolution of the sector. So we feel comfortable to take that decision at the end of 2018.

So, Nuno, probably if you want to talk about...

Nuno Alves: There are a few questions on debt. One is related to the cost. Clearly, the cost as expected has come down, maybe a little bit faster than people expected. We see it to continue to go down and probably beginning 2018 in as long as we continue to see the rate level of seven and 10-year bonds where they are today, I think they will come down faster than we had guided a year ago. So that will be good news for the company.

And as far as the absolute debt level, as António mentioned, today, it's impossible until we know the result of EDPR. But we maintain the objective that is in the business plan, which is about €400 million of operating cash flow to go down to pay down debt every year. And that does include also the move which you don't see, but it affects debt of the part of the subsidies to employees through a fund. So when you look at debt just by itself, it doesn't show up, but if you include debt in provisions that number stays the same.

So we continue to see debt come down. We have no reason to change the guidance we've reviewed before. We are maintaining the levels of investments at the agreed pace on the business plan. So 2017 is closed and for 2018, we already know where it's going to end up. So we are fairly comfortable with it and we are on the right track.

António Mexia: There was the last question about people asking about figures of regulatory risk because people, I think, that I was clear on CMEC and regulatory review. Only thing that I would like to state here that figures that were out there in the press, they really make no sense at all. And I believe that what concerns the market evolution, the risk of any change on that front is over, over, over, discontinued. So let's be clear on this front.

Miguel Viana: We have just a question on the effective tax rate for the full year of 2017. So, we maintain the previous guidance which is below 20%. So there's no change on that guidance on the effective tax rate. And I think we have just a few more questions which are more technical, so we'll answer at higher level.

So we'll go back to our CEO for final remarks.

António Mexia: So, thank you for your questions, for being present, but then especially for those for the questions that helped us clarifying guidance. We are very clear on that guidance. I think that we are very clear in what concerns also regulatory revision and the over discounted risk.

I think that we are very clear about the EDPR non-price revision and especially that we don't intend to do anything in the short and medium term, if we don't reach 90%. So, of course, we have been transparent in that front. And I'm also very clear in what concerns, not having conversations and consultation on this sector.

And also being clear that we have already incorporated in our vision in terms of the end market but also Brazil end markets and all these, the recent evolutions in terms of hydro, in terms of prices and then of course in terms of changes of the structure on the supply, on the upper side, on the generation side. So, thank you, for these questions that allowed us to be clear in all those fronts.

Thank you very much. For those that have vacations, have a good vacation, and see you soon. Bye-bye.

Operator: Thank you. That does conclude the webcast for today. Thank you all for participating and you may now disconnect.