EDP – ENERGIAS DE PORTUGAL

Friday, 29th July 2022
11:30 Hours UK time
Chaired by Miguel Stilwell d' Andrade

Company Participants

• **Miguel Stilwell d'Andrade**, Chief Executive Officer

• **Rui Teixeira**, Chief Financial Officer

• **Miguel Viana**, Head of Investor Relations

Miguel Viana

Good morning, ladies and gentlemen. Thanks for attending EDP's First Half 2022 Results Conference Call. We have today with us our CEO, Miguel Stilwell de Andrade and our CFO, Rui Teixeira, which will present you the main highlights of the first half 2022 financial performance and then update on strategy execution. We'll then move to the Q&A session, in which we will be taking your questions, both by phone and written questions that you can insert from now onwards at our webpage. This call should last close to 60 minutes.

And I give the floor now to our CEO, Miguel Stilwell de Andrade.

Miguel Stilwell d'Andrade

Thank you, Miguel. Good morning, everyone. So, good to have you back, and thank you all for attending this results conference call.

I think we can move straight into the presentation, and if we go over to Slide 4. So, the second quarter of 2022 had a good recovery, particularly given the very challenging first quarter. And we had essentially good performance in the following, wind and solar on the back of capacity growth, good resources and higher selling price. We talked a bit about this on the EDPR call. But we also had good performance on the electricity networks, given inflation impact in the tariff updates and the ForEx in Brazil. And also, good performance in the thermal activity, with positive results on the portfolio optimization, also in energy management.

On the other hand, in hydro production, we continued low also in the second quarter of 2022, but far less negative than in the first quarter. So, we had a total hydro shortfall of minus 2.8 terawatt hours versus the expected in the first half. So, that's one of the main causes to the negative net profits in Portugal.

At the net profit level, we saw an increase in financial costs, mostly due to Brazil, given interest rate hikes, and we had strong performance in EDP Renewables and EDP Brasil that then resulted in higher minority interests, so, as you know, because of having minority there.

So additionally, the first half of the year was marked by good investment execution, with 97% of EDP's investments focused on renewables and electricity networks. I think it's worth highlighting that as of June, we had a record 3.2 gigawatts of capacity under construction. So, that's a record for EDP. We expanded to Asia Pacific with the acquisition of Sunseap we closed that in this first half. Integration is going at a good pace. And we're also investing in networks, namely with the transmission growth in Brazil. We had the acquisition of EDP Goias and some new lots coming operational in this first half.

So now, let's take a step back and look at some of the more macro evolutions, particularly in Europe, because I think this has been one of the key, let's say, changes or key highlights in the in the second quarter. So, RepowerEU was presented in May by the European Commission. And I think the interesting thing was it addressed not only the decarbonization targets, but also the challenges to energy security, independence, and affordability, so this energy trilemma.

We had updated targets, even more ambitious than ones presented by the Fit for 55. So, to achieve the proposed 1.2 terawatts of renewable capacity by 2030 in the European Union, wind and solar annual capacity additions will have to ramp up to 36 gigawatts and 48 gigawatts, respectively. That's 3.5 times and 2 times increase versus 2021 levels. So, very ambitious targets, which represent a good growth opportunity for EDP.

The European Commission also understood that to reach these targets and to get the desired energy security, it's absolutely critical to address the main bottlenecks of renewable additions, mainly permitting and grid connection. Again, we've talked about this a couple of times.

On the faster permitting, we do feel there's an urgency to simplify and standardize processes, namely through digitalization and reinforcement of human and technical resources. And only with such measures will it be possible to reduce the average development time to two years. As you know, many of you know, nowadays, the fastest permitting process in our European markets is around three years. So, a lot of effort is needed on the subject, because in many places, it's still about five years. So, clearly, the way to go here.

On the easier grid connection, RepowerEU also aims at facilitating hybridization and repowering and also some long-term strategic grid planning goals. So, again, only this way will it be possible to maximize connection capacity and to take advantage of the different renewable technologies.

All this being said, RepowerEU has strong ambition to get through the existing bottlenecks in the renewable capacity additions. And of course, there are challenges that will need to be addressed, the lack of visibility on the rollout of annual targets or the interconnection capacity needed until 2030. But I believe that now, it's the responsibility of the Member States to implement concrete measures. And we are seeing and we are having that dialogue with the different Member States on exactly how these bottlenecks can be overcome. So, we are seeing some progress and certainly, willingness on behalf of governments to move forward on this front.

So now, let's move to Slide 6 and talk about a specific transaction that we announced today, and I think very much following on from just the previous slide and sort of the

European ambition. We announced the entry into the German and Dutch markets with the acquisition of Kronos, a solar PV development platform. So, Kronos has a pipeline of renewables projects of around 9.4 gigawatts, spread throughout Germany, which represents about 50% of the total pipeline, France, the Netherlands, and the UK.

So, Germany is the biggest solar market in Europe. It just recently announced the Easter Package and it reaffirms its position as one of the largest and fastest growing solar markets in the world. The package targets 360 gigawatts of renewable installed capacity by 2030 and close to 40% of the expected solar growth in the EU. On top of that, I'd like to add that this new market can be an opportunity for EDP to complement solar PV with hydrogen and storage technologies, and eventually to explore hybrid projects, namely with wind.

Regarding the economics, so we're investing EUR250 million to acquire a 70% stake in the company. The founders will keep 30% equity stake and continue involved in the management of the business, ensuring alignment of interests between them and EDP's strategy. There are success fees, obviously, over the first five years, which are dependent on capacity delivery. And then also a put/call option post 2028 for the remaining 30%, with the pricing dependent on the capacity evolution. So, again, I think it's a good way to structure this transaction. It's risk sharing of the development between the founders and EDP.

Overall, the structure of the deal, we believe, allows us to be fully aligned with the management of Kronos, sharing this development risk. And we think it's a great deal, great opportunity to increase EDP's presence in Europe, especially with the RepowerEU plan underway. So, they are very complimentary to our existing portfolio, and that's one of the reasons we like the deal.

If we go on to next slide, I mean, just to show the impact of this. So, with this transaction, EDP reinforces its position on the RepowerEU opportunity and is now present in 12 European markets. Just to give you an idea of how important these new markets are, you see on the right-hand side of the slide that we're present now in markets, which are expected to have around 2 times more growth than what was in our previous, let's say, markets, so representing a total of 90% of the EU expected growth. So, it's actually even higher than the expected additions for the US market in the same period.

So basically, wrapping up this point, definitely, RepowerEU is a major opportunity for Europe to ramp up its renewable additions. To achieve security of supply, to have energy affordability, I mean, clearly, renewables continue to be and are, on a relative basis, much cheaper than gas or coal alternatives. And this way, we continue to make sure that we are leading this energy transition and having this increased exposure also to Europe, namely through the entry into Germany. So, I think in general, it's a good complement to our growth ambitions.

If we move on to Slide 8 and talking a little bit about our target capacity additions. So, as we mentioned on the EDPR results presentation, we've now reached 10.6 gigawatts of committed capacity in the first half of 2022. This represents 53% of the target additions until 2025. Of those, 10.6 gigawatts, 3.2 gigawatts were already added to our portfolio and are operational, another 3.2 gigawatts are under construction, as I mentioned earlier, it's a record number of gigawatts under construction, and we have 4.3 gigawatts already committed and secured.

It's worth highlighting that Europe and North America are EDP's main markets. So, we have more than 70% of the committed capacity allocated to these regions. And in terms of technology mix, wind and solar PV, they continue to be the main technologies. But wind offshore and Solar DG are gaining momentum, already representing 10% and 8% of the committed capacity, respectively.

I'd also like to mention the recent positive developments of solar PV in the US. So, the two-year waiver on the anti-circumvention investigation gives good visibility now for the 2023 and the first half '24 capacity additions, although with no impact in 2022. Also, just to mention and, obviously, this is very recent news, actually the last almost 24 hours, the Inflation Reduction Act, which was announced in the US. If approved, and I caveat if approved, because this has been a roller coaster. Just recently on the EDPR call two days ago, we were saying it hadn't been approved or we didn't expect it to be approved. But now, apparently, there is an agreement. This can be an important step to support renewables in the US. So, we see this as a positive, if approved.

In a nutshell, the 10.6 gigawatts represent 53% of our target for 2025. We have long-term contracts with attractive returns, and we have good strong visibility on the delivery of our business plan.

If we move on to Slide 9 and do a deep-dive on Solar DG, and the reason we're doing that is because sometimes this is an overlooked segment, but one which, I think, is one of the fastest growing on a relative basis, one of the fastest growing segments in the Group, and I think it's worth dedicating a little bit more time to this and so, that's why we put in the slide. So, it's a technology that's definitely been gaining momentum. It has very attractive economics. It's faster development than utility scale solar PV. It's got higher cash yields and so, shorter investment paybacks, and we already have a pretty geographically diverse Solar DG platform. So, we're present in 12 markets, with 1.4 gigawatts of secured capacity.

At the EDPR level, we have Solar DG in North America and Asia Pacific. In the US, we're mostly focused on B2B, so cross-selling with our utility scale operations. In APAC, we have a leadership position through Sunseap, which we acquired earlier this year. At EDP level, we're present in Iberia, Italy, and Poland. And while in Italy and Poland, we're only focused on the B2B segments, in Iberia, we have B2B and B2C. So, we have an integrated supply solution for our clients. I think it's worth mentioning that RepowerEU also reinforces Solar DG as part of the solution for energy independence. It doubles the capacity target versus the Fit for 55 and it aims to reduce the permitting time to three months.

Finally, at EDP Brasil level, it's mainly focused on the B2B segment, and there are also some interesting projects in which you can have solar projects supplying a B2C consortium of clients. So, overall, this already begins to have a good critical mass and we see strong growth in the segment. And so, we'll be giving more visibility on this over time as this business develops.

So, now, let's talk about electricity networks on Slide 10. We've been increasing our investment in networks. The investments pretty much doubled year-on-year to around EUR700 million in the first half. This segment is extremely resilient in our portfolio. It's played a critical role as an energy transition enabler. So, these are strong, stable investments with decent growth. The investment was mainly done towards grid digitalization and resilience. So, as of June of '22, we had 5.7 million smart meters deployed, so another 700,000 more than year-on-year.

In Brazil, EDP has taken important steps towards expanding our operating asset base. So, we completed the acquisition of CELG-T, formerly known as EDP Goias. We're now integrating that. We've also started the operation of four new transmission lots. And one point I'd also like to mention, which I think is important, the networks are very well protected against inflation. In Portugal, the rate of return on RAB is indexed to the Portuguese 10-year bond yields and in the first half of 2022, is around 5% or 4.94%. So it's an increase versus the 4.7% defined in the summer by the regulator. In Brazil, the distribution revenues are indexed to inflation, and this has also had a year-on-year increase of around EUR70 million in the first half.

And then I'd also like to point out that in August, so probably next week or two weeks from now, EDP Espirito Santo, one of our distribution concessions there, will have a tariff revision. We believe that the revision will be positive despite the final numbers only being published in August. But we think that that will obviously be positive and reflect a big part of the inflation.

Let's go into regulatory system in Portugal and again, in the past, this has been an area sometimes of concern. I think at the moment, and the slide I think will exemplify that, we actually think it's extremely stable and positive for consumers in Portugal. And so, the overall system is stable and predictable. It's also a good example, because the Portuguese system has a high penetration of renewables. And so, it's a good example of showing what systems of high penetration of renewables, how resilient they are in this high energy price environment.

So, the renewables in Portugal, as you know, many cases are remunerated through a fixed feed-in tariff, which is updated to inflation. So, it's currently on average of around EUR90 per megawatt hour. If you look at the graph on the left, you can see that contrary to 2020, the feed-in tariff is now lower than the wholesale price, which means that what used to be a cost for the Portuguese consumer is now a surplus. So, the system is benefiting, let's say, from that higher wholesale price, because it's buying cheaper renewables and selling it in the wholesale market, and that translates into a benefit then for consumers. So, the regulated tariff, as you can now see on the graph in the middle, the regulated tariff in Portugal has a component that is impacted by the surplus, which is the global use of system. And as you can see, despite the increase in the energy prices, the surplus generated by the renewable feed-in tariffs provided relatively stable regulated residential tariffs. So, in fact, in Portugal domestic consumers had a decrease of 2.6% in the last regulatory update.

So, just a pause there. In this context of very high energy prices, the consumers in Portugal are seeing a decrease and the system is stable. And I think that's the third graph, which is that this has not been done at the expense of an increase in system debt. The system debt is actually declining. It's now at its lowest, certainly for the last decade. It's had a 65% decrease just in the last two years, and we expect that the system debt will be fully paid down over the next 12 to 24 months.

So overall, despite the high wholesale electricity prices, the current regulatory framework in place allows for stable regulated residential end-user tariffs and a continued system debt decline in the Portuguese system, so, again, the value of an energy system with high penetration of renewables and a stable regulatory framework. I cannot stress this enough. I think it's really showing the resilience of the system and it's a good case study I think for other countries as well.

Slide 12, and just the last slide from my side before I turn it over to Rui. So, just touching on ESG excellence. I think it's important to note that we continue to maintain a high level of renewable generation, 75% still coming from these technologies as of today. CapEx fully aligned with EU taxonomy, almost 100%, 97% aligned. So, definitely very good in terms of that ESG component. And again, something I've mentioned previously, but we participated in the UN Ocean Conference, which was actually hosted here in Lisbon, Portugal. We subscribed to the nine principles of the Sustainable Ocean. So, overall, I think a good quarter for ESG. Just maybe also to mention, we continue to be in the top 10 of the S&P Global Clean Energy Index. I think that's quite relevant for us.

And lastly, just to mention, we're proud to be in the Bloomberg Gender-Equality Index for the second consecutive year, and I think that really shows that we value and are committed to promoting equal professional opportunities for both men and women, so something that's been certainly subject to a lot of focus on our side in terms of managing our people.

With that, I'll stop there and turn it over for Rui to go through the financial performance. I'll be back. Thanks.

Rui Teixeira

Thank you, Miguel, and good morning to you all.

Going into EDP's financial performance in the first half. I would like you to move on to Slide 14. I mean, here, you can see that we have a recurring EBITDA increasing 19% year-on-year to around EUR2 billion by the first half of the year. So, if you were to exclude FX impact, namely the US dollar and the Brazilian real appreciation in this period, the EBITDA increase would be about 13%. So, still quite relevant.

Recurring EBITDA for the wind and solar platform was up by more than EUR300 million, supported by high average installed capacity and recovery of the wind resource. In electricity networks, recurring EBITDA increased by 25% year-on-year, mainly driven by the growth in the Brazilian networks. This is due to a positive annual tariff update and significant depreciation of the Brazilian real.

And finally, on an integrated basis, despite an important recovery in the second quarter versus the first quarter 2022, the client solutions, energy management, and the hydro platform, they were penalized by the fact that we had 2.8 terawatt hours of hydro production shortfall, although this was partly mitigated by increased thermal generation.

So, if we move now to Slide 15, EBITDA from EDPR increased 49% year-on-year. This was positively driven by 10% growth in installed capacity, an improvement in renewable resources, which improved 7 percentage points year-on-year to 2% above the long-term average. This contributed to a 16% increase in electricity generation that we sold at an average selling price 27% higher year-on-year. Also, asset rotation gains that reached close to EUR100 million and, of course, this reflects the closing of the two transactions, one in Poland and the other one in Spain.

If we now look to the networks on Slide 16, the first half was marked by a strong performance of the networks platform, with our recurring EBITDA increasing 25% year-on- year to EUR732 million. In Brazil, EBITDA rose 70% in euro terms, 46% in local currency and, of course, this is impacted by the inflation update on the regulated tariffs or the regulated revenues, the increase of the electricity demand as the economy is recovering and growing number of customers, and better performance on the sale of electricity volume surplus in the wholesale market. Also, the integration of EDP Goias in EDP Brasil transmission activities had a positive impact.

In Iberia, EBITDA increased 6%, and this is mainly driven by the efficiency gains coming from the Spanish operations due to the integration between our operations in Viesgo, so effectively demonstrating that we are fully capturing the synergies that were planned at the acquisition.

Now, on to Slide 17. So, from an integrated perspective, client solutions, energy management and the hydro is where we see the impact from the severe drought in Iberia and the recurring EBITDA decreasing EUR147 million year-on-year. So, in Iberia, there was a negative impact of a, as I mentioned before, 2.8 terawatt hours hydro shortfall, with the wholesale electricity prices at around EUR206 per megawatt hour. This was partly mitigated by the improved energy sourcing costs on lower energy wholesale prices in the second quarter, which is a positive, given our short position, the increased thermal generation with 3.2 terawatt hours of higher thermal generation in this period, and optimization of our hedging positions in the energy markets throughout the second quarter of 2018. In Brazil, EBITDA increased 29% and this is on the back of a strong hydro recovery that allow for a 21% increase in generation.

So, if we move on to Slide 18, just to further detail the dynamics of our integrated portfolio. So, despite the negative deviation of EUR0.2 billion versus our initial expectations for the performance of the segments in the first half, the second quarter 2022 registered a significant recovery versus the first quarter, in which we had a negative EUR0.4 billion deviation.

How is that? So, the negative impact from the hydro shortfall was considerably lower in the second quarter. In the second quarter, we had a 0.2 terawatt hour shortfall versus 2.6 terawatt hour in the first quarter. Of course, this has to do with, as you know, the first quarter is where we have highest concentration of hydro production. Also, the improved energy sourcing costs on the back of a decreased wholesale electricity prices, which, as you know, is also I mean, this is one of the results of introducing the cap in the Iberian wholesale market.

Additionally, there was an optimization of our hedging positions in the energy market throughout these last three months, following, of course, the increase in prices and volatility that we saw, and we are still seeing in the European gas markets, and an increase of thermal generation volumes with attractive margins that ended up mitigating our losses.

And if you remember, this was something that we also highlighted in the previous earnings call that we would have some mitigating effect from thermal margins throughout the year.

Finally, a note on this negative EUR0.2 billion of deviation in the first half versus our estimates for the period, which is mostly justified by a negative EUR0.2 billion mark-to-market of gas financial hedging due to the increase on the spread TTF to Henry Hub for the years 2023 and 2024. We expect to revert this as we get into those years. So, it should be reverted around 65% of this impact in 2023, around 30% in 2024, and this is effectively through higher operational margins at the moment when we effectively get the physical gas deliveries.

So, if we now move to the financial costs on Slide 19, excluding FX differences and derivatives, adjusted net financial interest increased EUR170 million, reflecting a 140 basis point increase in the average cost of debt to around 4.5%. But this is mainly explained by Brazil, which more than doubled its financial costs to EUR151 million, given the rising cost of the Brazilian real denominated debt, which is indexed to inflation and, of course, represents around 15% of our total debt. But please note that the average cost of debt in Brazilian real has increased from 8.6% in the first half of last year to 13.4% in the first half of 2022.

Financial costs, excluding Brazil, also increased around 37% due to a EUR2 billion increase year-on-year in average gross debt and a 30 basis point increase in the average cost of debt if we exclude Brazil. So, with a slight increase in the rate of US dollar. Again, worth to highlight that in March, we issued a EUR1.25 billion 7.5-year green senior bond at 1.9%, which was then swapped to US dollar, about EUR500 million swapped to US dollar at a rate of 3.85%, which is effectively lower than what we would see in today's rates. So, I think it was definitely a good decision to issue at that point and do the swap.

Moving on to Slide 20. Just again, an update on our exposure to inflation. Our portfolio remains well protected against inflation and yield increases, which is extremely good, particularly in the current macroeconomic context. And as mentioned also in previous earnings calls, regarding inflation, we can break down the gross profit in about 35% of merchant/hedged, mostly concentrated in Iberian electricity market, which carries potential upside in a rising prices context, particularly from 2023 onwards as hedges roll out. Around 40%, which is linked to inflation, which acts as a natural hedge. This block refers to almost 100% of our operations in Brazil that compensates the increase in financial costs, networks in Portugal and around 30% of EDP Renewables revenues. And finally, flat revenues which represent 25% of the portfolio that are mostly related to electricity networks in Spain and another 30% of EDPR's revenue mix.

Just a comment on our debt structure. Roughly 70% of our debt is contracted at fixed rates, 41% represented by green bonds and more than 50% of the maturities are scheduled post 2025. So, all in all, we remain well protected against inflation and rising yields, with a significant share of the revenues linked to inflation and a debt structure, which is mainly contracted at fixed rates and the one which is variable as it's pretty much hedged through the revenue streams, which is the Brazilian case, as I mentioned before.

So, if we move now to Slide 21, on asset rotation, I think as explained over time, it's extremely important for the business plan. As you know, we intend to rotate about one- third of the 2021 to 2025 capacity additions target within this period. And I think it's important to highlight that even though we have this, the current market dynamics with high interest rates, the fact is that interest for renewable and the demand for renewable assets continues very strong. We continued to see high appetite from investors even with this upward movement in yields, which are effectively offset by higher energy prices and, therefore, from a valuation perspective, the higher energy prices is offsetting any negative impact coming from the yields. At least, this is what we are seeing until now.

So, this being said, and we do expect another solid year in terms of the asset rotation execution, with gains above the EUR300 million or on average per year that we said in the business plan. So, as of today, we closed two transactions, one in Poland at a very attractive enterprise value to megawatt multiple of EUR2 million that was closed in April. The other one in Spain that we closed in June at an EV to megawatt multiple of EUR1.8 million. And additionally, we signed two other deals, one in US already in the past and the other one last night in Italy that we are currently awaiting financial closing, along with other transactions that we currently have under negotiation.

So, overall, we have already secured EUR3.1 billion of asset rotation proceeds. This represents around 40% of the EUR8 billion target that we presented in our business plan.

And also, as Miguel said before, for 2022, we do expect to have asset rotation gains above this EUR300 million average that we stated in our business plan.

Slide 22. Let's look into the net debt. It increased EUR2.6 billion to EUR14.2 billion. This was impacted by the of course, the net expansion investments that amounted to EUR2.4 billion, following the acceleration growth mainly in renewables and networks and the acquisition of Sunseap and EDP Goias, and investment in offshore through auction winds, the dividend payment in April and effects of exchange rate fluctuations that had a negative impact of EUR0.4 billion on net debt due to the Brazilian real depreciation, and a positive impact of EUR0.6 billion reduction of regulatory receivables and this is mostly in Portugal.

Just to finalize on the net profit, it decreased EUR26 million to EUR301 million recurring net profit in the first half of 2022, and this was mainly impacted by the increased financial cost in Brazil, as I said before, driven by the FX, and also the higher cost of debt indexed to inflation. Also, higher non-controlling interests on a stronger performance from EDPR and EDP Brasil.

So, I would like to take the opportunity to thank you all for your time today. And Miguel, back to you for closing remarks.

Miguel Stilwell d'Andrade

Thank you, Rui. So, just a couple of comments here to give you an update on our expectations for the future, namely for 2022 and then in terms of business plan execution. In relation to '22, we do expect the strong performance of the second quarter to continue. I mean, certainly strong performance in renewables through volume growth, year-on-year capacity additions, good average selling prices, asset rotation execution. I mean, the deal we announced today in Italy, for example, might close in the second or in the third or fourth quarter, but basically, that will be coming through.

The second point is higher thermal generation and improved energy management performance. They're expected to compensate for the hydro shortfall that occurred mainly in the first quarter of 2022. Now, I just wanted to highlight that this assumes that rain levels will be in line with the average for the fourth quarter. But we are assuming slightly lower hydro generation versus average, given the current low reservoir levels. In other words, we're assuming it rains as normal, but we don't necessarily produce all of it, because we do need some of the reservoirs. We want to recover some of the current low reservoir levels. On networks, we expect the good performance to continue, namely with inflation updates and efficiency. So, I think that's something that we expect to also be recurring.

So, all things considered, these drivers should result in a recurring net profit above 2021, which is what we had indicated earlier in the year. So, despite a slight roller coaster, but I think we are on track for that. Now, obviously, there is quite a lot of volatility in the market, a lot of uncertainty. But I would say as of today and given what we know, we should be able to get to that slightly higher recurring net profit versus '21.

With respect to business plan execution, so we are on track to deliver the 2025 target for renewable capacity additions, so with the 53% of the 20-gigawatt goal already committed. As I mentioned, we have a record number of megawatts under construction at the moment, 3.2. We are expecting to build over 4 gigawatts in 2023. So, those are already lined up. So, it will be an intense year on the engineering construction side. But as I mentioned, we already have a lot of people working, not just on delivering '22, but already beginning to work on 2023 projects.

Regarding asset rotation, so we had a strong 2021. We also expect 2022 to be a good year. We have around EUR3.1 billion already secured, so the 40% of the EUR8 billion target, and it's also a number that we mentioned just a little while ago. On top of that, I mean, the current energy market is definitely characterized by higher power prices for longer. I mean, I remember a couple of quarters ago, it looked like this is going to be a short term, let's say, event. But it certainly looks like it's going to be higher for longer; used to be lower for longer, now it's higher for longer, but with rolling over of our hedging contracts. So, there should be a gradual improvement of average electricity selling prices above our assumptions in the business plan. So, I think that's something, which will feed through into 2023 and beyond.

Overall, I'd say we are comfortable for the remaining of 2022 and confident that we will achieve the targets we committed to in the business plan until 2025.

So, again, thank you for attending this quarter's results. We can now move to Q&A. And then I'll be back. I'll make some final remarks. Thanks.

Questions And Answers

Miguel Viana

We can go now to the questions on the phone. I think the first question comes from Manuel Palomo from Exane BNP. Manuel, please go ahead.

Q – Manuel Palomo

Hello, good morning. Thanks for taking my questions. I'll ask maybe three, but I'll try to be very, very short. First one, on the announced asset rotation deal this morning, I mean, multiple is very attractive I guess for the solar. But my question is whether there is any clause protecting the buyer from potential regulatory intervention. That would be the number one.

Second one, on the other news this morning, on the deal with Kronos and particularly on Germany, new market, although arguably more competitive one, at least in the past. Does this move means that high return markets are not enough to cover your growth expectations? So, maybe you're expecting similar returns in Germany versus other markets.

And the last one will be, I'm curious, on one of your slides, you mentioned the DG and the distributed generation. And I wonder whether, looking at the slide, would it make sense to have your assets for the year split between EDP, EDPR, and EDP Brasil? Wouldn't it make more sense to put all assets on the same company and in that case, who you think should be the owner? Maybe EDPR? Thank you.

A – Miguel Stilwell d'Andrade

Thank you, Manuel. So, great questions. In fact, I think you asked me on the call on Wednesday about M&A, right?

Q – Manuel Palomo

Yeah.

A – Miguel Stilwell d'Andrade

So, I hope I gave you an answer, which is consistent. Now, listen, but in relation to your question, so asset rotation in Italy, clause on regulatory intervention. I don't know if you're talking about windfall. So, once we close, it's closed. So, there is no sort of, let's say, retroactive mechanism to adjust price or anything. So, in Italy, the mechanism that existed was up till April, I believe. And so, once we have the transaction closed, there will be no retroactive for any changes. So, they will assume all or any regulatory risk going forward. So, in that sense, it's a clean deal.

On Kronos, listen, I think here, first, we also need to look at the returns as a function also of the cost of capital. And obviously, that's why when we talk about cost of capital, we talk or present by IRR over WACC, things like that. We look at it on a risk adjusted measure. Germany is an incredibly large market, and which is expected to grow. And I would just like to highlight some of the numbers that we had on Slide 6. Germany is expected to have around 360 gigawatts of renewables installed capacity until 2030 and growing sort of multiple dozens of gigawatt per year over the next couple of years. Germany clearly has to solve an energy independence issue and also an affordability issue at the moment, given the gas situation.

So, we think Germany is going to explode. It has to. I mean, there is no alternative. And so, what we are doing is positioning ourselves for that growth. We're coming in early, and we expect that the market will develop to be able to enable that growth, which will be in PV, which will probably be the easier one. I'm sure it will also be offshore. But essentially, I think it’s there certainly a macro issue with Germany that needs to go forward.

So, we think that the returns will be there. I think it's worth just also mentioning that the way that we structured the deal. So, this is not just, even the intent of the success fees are not just done on a megawatt basis. It has to be megawatts with profitability. And so, I mean, we had a specific negotiation on that and I think that's something we've learnt certainly, given the many years we've been doing this, to try and find the right incentives and the right way of structuring these things. So, it's not just going to be as a function of megawatts, but also as a function of the profitability of those megawatts. So, if it's not there, then obviously, the success fee is lower, or it's adjusted. So, first, so number one, Germany is an incredibly large market and expected to explode; number two, the way we've structured it takes into account that it has to be profitable megawatts; and number three, we think that we will, we do believe that, let's say, those returns need to be seen in the context of what is the cost of capital for investing in Germany.

On DG, it's a good question. And listen, we deliberately put out the slide, because it is something that we are working on and we are conscious of. This has been growing as a function of, well, obviously we had a DG platform here in Europe, in Portugal, Spain, where we had most of our customers. In Brazil as well. Sunseap has a very strong distribution, or distributed generation platform as well. It also has good utility scale. So, it's growing on both fronts. That's within the EDPR business. And in the US, we have, we are only present in the US through EDP Renewables. So, what made sense for us in terms of synergies and in terms of leveraging our platform there was to do it through EDPR.

I think the way it's working now is okay, because it's also growing in the different markets. Over time, we may think about the organization, and I don't have a specific answer for you. I think it's debatable on which side it should be, but it's something we're working on and I'm sure we'll come back at some point to give you more visibility on that.

Q – Manuel Palomo

Okay.

Miguel Viana

Our next question comes from Arthur Sitbon from Morgan Stanley. Please, Arthur, go ahead.

Q – Arthur Sitbon

Thank you for taking my questions. The first one is on the asset rotation deal in Italy. Given the valuation secured, I had, I was under the impression that you could easily have a capital gain of close to EUR200 million on this deal. I was wondering if you could comment or at least give a broad idea of where it could land?

The second question is on the Kronos acquisition. I was wondering what could be the time horizon for the development of offshore projects and whether or not it could impact your, well, the growth prospects that you had formulated in your business plan. Thank you very much.

A - Miguel Stilwell d'Andrade

Okay. Thank you, Arthur. So, in relation to the first one, I mean, maybe it will be close to that number, probably not reaching it. But it will, you're certainly in the ballpark.

In terms of Kronos, what I can say there is, given the pipeline, and we did an in-depth analysis of the pipeline and the maturity in the different markets that we would expect to have around 3 gigawatts over the next five or six years developed and built. So that's, let's say, more or less the time horizon of development that we see in relation to that pipeline. Again, we like, when we do M&A, we do prefer to do it with pipeline where we think we can then add more value going forward, and this is clearly the case.

Q – Arthur Sitbon

Thank you.

Miguel Viana

Next question comes from Javier Garrido from JP Morgan. Javier, please go ahead.

Q – Javier Garrido

Thanks, Miguel. Good afternoon. I just have one question and it is with regards to your hedging in Q4, because you have said since 12 months ago, I think that you are 100% hedged for 2022. Now that you are expecting hydro production below the average, as you have very well explained, I was wondering what is the level of hedging relative to the production. Are you now 100% hedged versus that level of expected production or are you overhedged? What would be your position with these updated hydro productions for this? Thank you.

A – Rui Teixeira

Hi, Javier. I mean, we will manage to be around 100% hedging. I mean, at some point, we do see that if we can get overhedged, then we adjust for that. So the point is that we would in advance try not to be overhedged. But as I said, this is something that we manage continuously. So, the target, that 100% towards the year-end. I mean, just for your reference, 2023, we are at around 60%. Yeah, that's it.

Q – Javier Garrido

So, sorry. Rui, to be clear, you are 100% hedged, assuming production, hydro production in line with what you have explained? Thank you.

A – Rui Teixeira

Correct. And then we will be managing this actively. If we see that for some reason we would be overhedged, we would be managing it actively, but you can consider it 100%.

Q – Javier Garrido

Perfect. Thank you very much.

Miguel Viana

Okay. The next question comes from Fernando Garcia from RBC. Fernando, please go ahead.

Q – Fernando Garcia

Thank you. Good morning and thank you for taking my questions. So, in the Iberian gas, in the Iberian supply, there was an improvement in second quarter versus first quarter. Can you provide what are your, the main drivers of this improvement? And I would like, I would appreciate that you give us some thoughts for second half. And if you can extend that thoughts for the second half as well in thermal and energy management?

Then the second question on gas derivatives, I think that's taking into account the evolution of the TTF prices. It's likely that at least in third quarter that that is going to continue worsening. So, I wanted to understand this reversion, how this works is, for the EUR200 million that you have in first half or use whatever number you finish in 2022. And then, trying to understand as well how this reversion works. Is basically related to the maturity of the gas derivatives or what is behind that? Thank you.

A - Miguel Stilwell d'Andrade

Okay. So, in relation to the Iberian supply, there is always some seasonality and the first quarter is typically weaker, the second quarter better. Over the second half, I would assume we would also be okay, like good. So, I think you can pretty much assume that the overall margin will continue to improve over the second half.

And in relation to the thermal and energy management, we can also comment, but we continue to see, certainly on the thermal side, strong spreads and so, I think that would carry on throughout the rest of the year to a certain extent. So, I think that would be our thoughts about how that carries on for the rest of the year.

In terms of energy management and gas derivatives, Rui, do you want to give a comment on that?

A – Rui Teixeira

Yeah. Sure, absolutely. So, on the gas derivatives, again, this is the contract that we have indexed to Henry Hub. Basically, what we do is that we hedge financially to cover the spread for TTF, because the TTF is our reference in terms of our cost for both the gas plants and the supply business. As we do that financial hedging, that is currently not being considered as hedge accounting and therefore, we have to book any mark-to- market.

In the context where we have TTF prices increasing, basically, then we get a negative mark-to-market. Once we start using the gases in the next year, 2023 and 2024, this is effectively when we will start seeing that unwinding effect of the hedges. So, the reason why I say that we will have a positive impact is, at that point, once we burn gas, we receive the gas and we burn the gas, the cost, the effective cost that we have is what is included into the hedges and basically, just when we will be unwinding this mark-to-market.

If you have to think through, in a context where we would see a continuous rise on the TTF price, then, of course, this negative impact on the mark-to-market would increase and the positive impact on the operational side in 2023, 2024 will increase as well. So, that's how the dynamics works towards the rest of the year. It will depend, for this particular item, it will depend on the evolution of the TTF.

Q – Fernando Garcia

Thank you.

Miguel Viana

Next question comes from Oliver Jeffery from Deutsche Bank. Oliver, please go ahead.

Q – Oliver Jeffery

Thanks very much. Thanks for taking my questions. So, a couple of questions, please. So, the first one is on hydro. You mentioned that later in the year in order to get the reservoir levels back up to a normal level, your hydro production might be lower than planned. Could you put some numbers around that? I mean, my estimates might be upwards of potentially 0.5 terawatt hour over the hydro year and also, potentially, looking at where the power price is and where you've hedged, to a 90 megawatt hour spread. So, maybe around a EUR50 million headwind from that. Can you check if that math is totally right? That's the first question, please.

And my second question is just on the asset rotation. So, if I heard you correctly, I think you said the Italian rotation potentially with a ballpark around EUR200 million gain potentially. If that is the case, obviously, that's quite significantly ahead of the EUR250,000 gain per megawatt you've envisioned previously. That's well over EUR1 million. And if that is the case, the other deals you're looking at, you're working on, are they potentially also at that similar level, or should we assume lower at more kind of the guided range of 300,000 megawatts?

And then just following on from Fernando's question there, with the movement in TTF prices that we've seen since the end of the half year and, obviously, a reasonable increase, if you were to do the kind of year-to-date additional loss that you might be seeing in Q3 that would negatively impact the P&L in Q3, could you comment on that? And obviously, that will unwind, but that might be helpful in terms of thinking about full year numbers. Thank you very much.

A - Miguel Stilwell d'Andrade

Thank you, Oliver. So, I'll take the first two and then Rui we can take the third. So, in relation to hydro, I mean, we don't have a specific number, because obviously it will also depend on what is the hydro levels and how we're seeing energy prices. So, it's more of a qualitative statement that we will look to manage our hydro and potentially get the reservoir levels up. But we don't have specific guidance to provide to at this time.

In relation to the second question, so I said close to, but probably not reaching it. I mean, clearly, it's a rich multiple. It would be great if all of our asset rotations have this multiple, but no. But I think we're not assuming that the others are necessarily in the same range. Obviously, this varies depending on the geography, depending on the technology, whether it's wind or solar. So, we provided the guidance of around EUR250,000. We have been managing to get better on average, but I would not say that this one is representative, or certainly would not wish you to include this level of premium, let's say, for additional asset rotations. So, this was effectively a good deal, just given the nature of the assets and in the current market context.

In relation to your third question, Rui, do would you want to take that?

A – Rui Teixeira

Yeah. Sure. Thank you, Miguel. Oliver, hi. Listen, I mean, this mark-to-market will effectively depend on the TTF price at the closing of the quarter. So, given the current volatility, I think it's very hard to say what would be the potential impact. But I would like, again, highlight two things. One is that whatever negative mark-to-market we could have and we're already having, could have going forward, it's a positive impact on the margins as we enter into 2023 and '24. And secondly, this is a non-cash item. So, I mean, the cash effectively materializes when we burn the gas or when we sell it to our customers in '23, '24. So, this impact in P&L is a non-cash item.

Q – Oliver Jeffery

Thank you.

Miguel Viana

Okay. The next question comes from Skye Landon from Jefferies. Skye, please go ahead.

Q – Skye Landon

Hi, thanks for the presentation today. Couple from me. Firstly, on the 35% of revenues being exposed to merchants or hedged revenue streams, could you perhaps provide some kind of update on the rough breakdown of how these hedges roll off and how much of this 35% is open in 2023, 2024, and 2025?

Second question on net debt. Could you maybe provide a bridge of the key movements in the second half or some kind of full year 2022 expectation level?

And then just thirdly, perhaps on the US news yesterday regarding the positive tax credit extensions and taxing reforms, can you perhaps outline some initial thoughts on this and how it could potentially change shorter and longer-term plans of capital allocation, both in and outside of the US? Thank you.

A - Miguel Stilwell d'Andrade

Okay. So, I'll do the third one and Rui, you can take the first two. So, in relation to the US, I mean, I think it's definitely positive, because as I mentioned, just on Wednesday when we had the EDPR call, quite frankly, we thought that was, that was dead. The probability was we're not describing any probability to it and just overnight, literally, I woke up Thursday morning and there was a news that the two senators had come to an agreement on that. So, it was rather unexpected, but, obviously, positive. I would just caveat this, as I mentioned when I was going through the slides that we need, we would like to wait and see until it's approved. It has been a roller coaster of will they have an agreement, won't they have an agreement. But it is positive that they seem to be talking, it sounds certainly much better than where we were a couple of or just 48 hours ago.

What are some of the major impacts? So, definitely, the 10-year extension of the existing ITCs and the PTCs with the phase-down after the 10-year period. There's also a shift in the structure to technology-neutral PTC. So that is, I think that's also potentially good.

There are other production incentives. For example, things like hydrogen for various components and the solar and wind supply chains. Some of the incentives are also linked to domestic production and domestic labor and things like that.

So, it could actually be more attractive, as long as you managed to get that domestic production in, which, to be honest, this obviously will create the right incentives to make sure we do that. And so, hopefully we will be able to get those bonus PTCs and ITCs for certain, assuming we achieve those thresholds of domestic content. So, I think that gives us an extra carrot to go after that extra piece.

So, in general, I'd say, looks positive. The numbers are also relevant. I mean, we're talking about $370 billion allocated to this area. So yeah, I mean, certainly better than where we were 48 hours ago. What does it mean for capital allocation? I mean, what I'd say is that we have our current business plan. Probably in the short short-term or the short term, it won't have any impact; medium, long term, as I said, because of the 10-year extension and the additional incentives, sort of over the next couple of years, medium, long term, it will have an impact. The exact quantification of that, we'll have to get back to you. It's just come out recently. So, we have to see how that reflects. But yeah. And so, as soon as we have that more detailed analysis, maybe we'll provide some further guidance on that. Thanks.

A – Rui Teixeira

Hi. And regarding the other questions, so in terms of the hedging, so again, just to be clear, so currently, we have around 100% hedged for 2022, and I'm talking about specifically Iberia. This is at the price around, actually above, EUR60 per megawatt hour. For 2023, we are 60% hedged and for the period '24 to '25, we are around 35% hedged. So definitely, still will be some upside to the current pricing scenarios.

And in what concerns the net debt, I would say that towards the year-end, we expect to remain broadly in line with the current level of debt. I mean, there are a couple of items worth highlighting. Yeah, I mean, of course, we'll have the execution of the CapEx plan and of course, bearing in mind working capital with the providers. Of course, the asset rotation proceeds. So, we mentioned before we have two deals already signed that should be closed before the end of the year and actually, there are some are ongoing negotiations. So, we would expect it will be an important contributor to the debt profile. And then again, of course, the organic cash flow and as we have seen, I mean, we do see important contributors in term of cash flow, driven by high power prices on the renewables side.

And also, we do expect keeping the positive evolution in terms of the regulatory receivables. This is mostly in Portugal. So, I would say, broadly, by the end of the year, I would expect broadly at the same level as of today. And actually, from a cost perspective, given that we have 70% of the debt at fixed costs and the remaining part is on the Brazilian real. As of today, I would expect, again, cost broadly in line. But the variable would be the Brazilian inflation numbers and of course, interest rates in Brazil. Also, maybe some on the US dollar side, but again, I would say, broadly, the same as in the first half.

Q – Skye Landon

Got it. Thanks. Thanks for the color, both.

Miguel Viana

Thank you. So, we'll try now to just to address a couple of questions here from the web. First from Jorge Alonso of SocGen.

So, considering the new German platform and the high growth expected, can EDP handle saturation in the growth or other regions will slow down or delay the projects to give preference to those ones?

A – Miguel Stilwell d'Andrade

Hey, Jorge. So, what I'd say is that, I mean, this certainly gives us additional ability to optimize our portfolio in terms of risk-return and allocation of capital. So, that's one comment I'd make.

The second comment is that we are, or we have started working on how this all comes together, sort of looking at things like interest rates, energy prices, policy changes, the CapEx per megawatt, regulation so that over the next couple of months, we can prepare and eventually come out to the market at the beginning of 2023 with new targets or new business plan where we can bring all of the different pieces together.

So, for now, we're just assuming that it adds to our optionality. But we will be doing a more thorough review over the next couple of months.

Miguel Viana

We have also from Jorge Guimaraes a question still about Kronos. EDP is looking to increase its exposure to solar PV in Germany and since you're not in Europe, is it possible to elaborate on the economics of solar PV in Germany, namely, load factors, economics, etc?

A – Miguel Stilwell d'Andrade

So, in relation to this, I mean, what I'd say is that the CapEx is similar to other European geographies, around EUR600,000 or EUR700,000 per megawatt at the moment. In terms of resource, around 1,000 hours. And then in terms of routes to market, I'd say both PPA markets and auctions are interesting routes and are delivering prices, which are still below current and forward merchant prices, but which, let's say, provide the necessary profitability to get these projects moving.

As I mentioned earlier in the call, I think Germany will have to achieve its target. It will have to make sure that the profitability is there. Otherwise, obviously, people won't invest. And for, I think for Germany but for many other European countries, this is almost an existential issue. So, it's not just a question of decarbonization. Do they have sufficient energy independence? So, we believe that the necessary regulatory framework will be there to incentivize the buildout of renewables. Otherwise, it won't be there. We think it has to be there. So, I think that will be taken into consideration.

Miguel Viana

You have another question from Jorge Guimaraes. What is the expected impact for EDP on the tax on energy companies proposed yesterday in Spain?

A - Miguel Stilwell d'Andrade

I think it's too early to tell. We still don't have enough detail on this. So, I wouldn't want to make any, or provide any guidance on specific numbers yet. I mean, as soon as we have a little bit more information and have also run our own analysis, then we'll provide feedback. But for now, prefer not to comment.

Miguel Viana

Finally, the last question also from Jorge Guimaraes. As of today, what is your expectation for 2022 cost of debt?

A – Rui Teixeira

Jorge, again, as I said, I would put it broadly in line with the first half number, with the first half cost of debt. I mean, the key variable there will be the fact that we have 70% of fixed cost of debt. For the remaining portion, which is variable, it's mostly Brazil. So, it will depend on interest rate evolution in Brazil. Again, bearing in mind that we pretty much are hedging the revenue side, which is also indexed to inflation. So, I would say that it would depend more on the Brazilian real, a little bit on the FX impact on the US dollar. So, for the current stack of debt, I would say, at this point, I would expect broadly in line with the first half.

Miguel Stilwell d'Andrade Okay. So, just slightly overtime, but maybe just some final remarks before we all go off for holidays. First, I think the second quarter of 2022 has definitely had a very strong recovery from a very weak first quarter. There's still challenging market conditions for sure and a lot of volatility in the market. But I think we've shown a good recovery and as I mentioned, we expect that over the rest of the year. We are optimistic and that we will have positive developments on several fronts, namely renewables, networks, thermal, Brazil.

Portugal is still poor profitability, given the high physical load. I think that's something that we also highlighted in our commentary and our sort of release, press release or market release. So, that's something, which is still weighing down, the hydro physical context. That's something that also penalized us quite a lot in the first half. We are very enthusiastic about the long-term opportunities in general and about the business plan execution. I think when we look around in all the different regions, I mean, the recent news around the US, the position in Europe with different countries and the European Commission really ramping up their ambitions in terms of renewable growth, so I think all of that, bringing that together, the outlook is extremely positive and it's just been reinforced over the last couple of months.

I think Germany is a great market. As I mentioned, I think it is going to explode. It has to explode. And so, I think Kronos provides us a good entry point there, and we're very happy and excited to start working with them and with the team and the founders to develop that business over the next couple of months and years. And I think the way we structured it is an interesting way for both of us, so it ends up being a win-win.

I think definitely RepowerEU presents the tools to tackle the energy crisis. So, as I mentioned, it's not just about decarbonization. It's also about energy independence, security, and price stability. Renewables is by far the most competitive technology out there. So, I'm a firm believer in that. If we get the permitting right, if we get the interconnections right, I do think that this will continue to grow. So, I think the path is clear. Definitely, the different countries and the companies need to step up and really unlock it and get this done.

I have to say we are and we have been, or we've just started working on how this will all come together, and I mentioned this also in relation to a question. Looking at where interest rates are, looking at where energy prices are, policy changes, the new targets, the CapEx per megawatt, the regulation and how attractive different projects are in different countries and regions, and pulling all of that together over the next couple of months, so that early 2023, we can provide you and the rest of the market with an update on how we see the company going forward.

So, have a great summer break, and I hope we catch up during the month of September. So, talk to you soon. Take care.

Operator

Thank you. This concludes the EDP first half 2022 results presentation. You may now disconnect your lines.