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ENG.MC - Enagas SA Strategy Update and 2019-2023 Outlook
Conference Call

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PRESENTATION

Antonio Lladen Carratalá - *Enagás, S.A. - Executive Chairman*

Good morning, ladies and gentlemen. Welcome to this conference call, and my name is Antonio Lladén, President of Enagás. I've got all the team of the company with me. And as we announced the results presentation for the year 2018, today, we're going to present our strategic update and the prospective for the period 2019-2023.

We had already told you some main points, especially the ones referring to the sustainability of the dividend policy in the last presentation. In the conference call that I allude to, we said that in the second or third week of March, we would try to make this strategic planning presentation, and it has coincided. As you very well know, last night, we published a relevant fact to the CNMV, to the stock exchange market. And I'm going to use this presentation regarding strategy to explain the main aspects of this operation that fits with our strategy.

The update that we present today is a continuation of the strategy that the company's followed since the year 2011, which has as one of its own priorities to focus the Spanish gas system in which we are the transmission system operator, so especially -- and the operation and the maintenance of the system with the efficient level and with the objective of guaranteeing a double objective, the supply, security and competition.

We are aware, of course, that our system is a mature system without major pending investments. That is why, bear in mind the main objectives, we want to keep our operational excellence, we want to maintain our good employment level and our good level of technical capabilities and to guarantee the trust of our investors and a sustainable growth for the company.

So based on these objectives in 2011, and you all know it, we started an internationalization process with very clear criteria that have the -- have remained in time. This outlook that today we present shows the continuity and the consistency of our strategic line. It also adds new objectives that are related to the energy transition and the decarbonization of economy.

Well, I've structured my intervention in 5 points. First, I will make a short overview of the global context of the natural gas development. Secondly, I will comment the 3 growth areas that we will focus for our strategy until 2023. Thirdly, we want to explain and give details of the United States operation that we have just announced that you will see fits perfectly with the strategy. Fourthly, I will present our prospectives for the period 2019-2023 that already takes into account the impact in global terms of the operation in the United States in our cash flow. And finally, I will make a reference to our commitments and advances regarding sustainability that, as you very well know, is a cross-sectional pillar that conditions the full strategy of the company.

So let me start with the first point: the global context that we -- in which we are operating. And it's a context that is marked by an energy transition and the advance towards a decarbonized economy. This is something that is out of our reach, of course. But we are at a moment of transformation, full transformation for our sector. And we know that natural gas and gas infrastructures for transport and storage in this moment are key.

I do apologize, renewable energies can no -- still cannot bear on their own the full energy demand that exists because there are matters that are pending to be solved -- technical matters that are pending to be solved, for example, the energy storage, the necessary calorific value for industries, as well as permanent availability, et cetera, et cetera.

The renewable energies will lead that energy transition, of course, but they will do it together with natural gas, which is, out of the traditional fuels, the one that can better contribute to contain the CO2 emissions and to improve the quality of the air.

In the presentation, you have specific data on the evolution foreseen for the energy demand and also for the natural gas and liquefied natural gas. I won't give you the details because you've got the charts in the presentation. But we also have to see this energy transition process from a global perspective.

Europe is at the lead. This is clear. But decarbonization will only be real if the main demand focuses take measures simultaneously. So let me give you a couple of examples that are really relevant.

First, United States is the country that has reduced the most of its emissions by 7.6% between 2010 and 2017, and that's thanks partly to their commitment towards natural gas. The demand of natural gas increased by 14% in these 7 years. And not just by chance, carbon demand has reduced almost 13%.

Another example, and I do apologize for this short break, another example is China. Despite its very strong growth, economic growth in the last decade, China has been able to contain -- relatively, contain the growth of their CO2 emissions, thanks to their commitment towards gas versus coal. For the coming years, we expect natural gas to continue to be above the growth of primary demand. That is, it will continue to gain share to coal and oil, contributing decisively to the reduction of emissions as an efficient cost.

The second point I wanted to share with you, is the strategic focus for 2019-2020 (sic) [2019-2023], the areas for growth. In this context, our challenge and our objective is to continue growing on a sustainable basis, always preserving our efficiency and the excellent operation and maintenance of the Spanish gas network.

As this system is already mature, our strategy for new investment is focused in 3 growth areas. The first, new businesses related directly to the challenges of the energy transition; projects in renewable nonelectric energy, what we call the renewable gases, biomethane and hydrogen. And for the time being, that will be for the national market.

Biomethane has got a short-term and midterm development. It's a renewable energy source that can be stored and the technology is available already today, and it allows to reduce emissions at the same time that it contributes to circular economy through a correct use of waste.

Hydrogen is an energy vector for the future that will be on a longer term and it can become the great disruption in the energy storage world, especially when energy is of a renewable origin.

For both renewable gases, biomethane and hydrogen, for these gases, we can use the potential of the infrastructure that we already have in Spain and other countries without having to create additional and significant investments.

At Enagás, more specifically, we have already signed 13 agreements with different companies and entities such as, as an example, Ente, Ferrovial, Repsol, (inaudible), Acciona and the regional government of Aragon and Balearic Islands. These new businesses that are related to renewable gases did not entail major investments or revenues for Enagás still, but we are aware that they are the future, probably even beyond the period of this update. We are, therefore, working on those issues with these agreements and these projects, and we do expect that from 2022 or 2023, they will represent major investments.

Our second growth area focuses the activities of our core business in international markets that we have identified as priorities for our strategic plan.

Since we started our internalization, we do follow closely the business opportunities that we might have in the markets where we are already present, but also in those markets that are stable and that may offer opportunities for growth.

These markets, therefore, are, the first one, Europe; and the second, America, more and specifically the Pacific axis, Chile, Mexico, Peru, Colombia and the United States. Always, always meeting our strict criteria for international investment that I shall recall. There are 6: stable results, control risk profile, [raw] as an industrial partner we're taking decisions, alliances with partners with complementary capacities, focusing always on our core business and sustainability as a cross-sectional strategic pillar.

Our third area for growth is what we call the expanded core. These are investments in complementary activities that are directly linked to our main business. And these are 3 departments: new complementary structures and services related to LNG, such as, for example, small-scale and bunkering services and opportunities for floating infrastructures and liquefactions that are related to our main markets.

The development of floating solutions, the environmental regulation in the maritime sector, the plans to improve the air quality in cities and the objective to reduce CO2 emissions represent momentum for gas demand in the maritime transport and land transport at the short and midterm, and that will allow to increase the use of our infrastructures.

Providing another line for work is to provide engineering services, training services and counseling services with a double objective: to foster our industrial role in the -- our expansion internationally and also to give value to our capabilities and to our experience.

And finally, the third role, but not less important, corporate and innovation and entrepreneurship. That's why we have really committed for this in the last years. That's why we have created the company Enagás Emprende to look for new solutions that will allow us to boost energy efficiency and decarbonization. And today, we already have 7 startups, 7 new companies that are working in this field, out of which you have the specifics in the presentation that comes with this conference call

(technical difficulty)

Enagás has agreed to invest in up to \$300 million in future investments in Tallgrass. These operations are detailed, on the one hand, by the relevant fact presented either before the CNMV and, on the other hand, in the communication that has already been registered with the U.S. Securities and Exchange Commission, the SEC, in the U.S.

I would like now to give you the details about this operation and how this fits in into our strategy. It is an investment into our core business and in the U.S., a country that has been identified for a long period of time as strategic for Enagás.

Tallgrass is an energy company, a midstream energy company that was founded in 2012. They own 3 interstate transport pipelines regulated by the Federal Energy Regulatory Commission, the FERC, and it has 2,400 kilometers in gas pipes in addition and an oil pipeline of 1,300 kilometers. The U.S. is currently the market with the most opportunities for growth in the world for midstream infrastructures.

Another point is that the operation is a strategic agreement with top-level partners, such as Blackstone Infrastructure Partners and also the sovereign -- the Singapore sovereign fund, GIC, 2 of the main investors in infrastructures in the world. Both have long-standing track record, a very well-recognized position in the industry and a strong presence in the U.S.

For quite a while, we had already been mentioning in these conference calls that we were in active search of adequate partners to jointly invest in international projects. This operation fulfills this objective by 100%. The operation also highlights the value that Enagás has as an industrial partner, and it is both recognized by

(technical difficulty)

our broad and diverse customer base and take-or-pay contracts allows for visibility and stability for long-term cash flows. The U.S. company has a consistent track record of increasing cash flows, dividends and sustainable EBITDA.

Tallgrass also has a solid project portfolio in which Enagás could study participating. And finally, this operation has a positive impact on our business model. And in addition, it entails an average annual dividend for Enagás in the 2019-2023 period of about EUR 60 million, as I said, per year, and a double-digit IRR.

As we have just announced the operation, it was actually last night, we are now going to give you the aggregated data for this period. And in future presentations, we will talk about this aspect in further detail.

Rating agencies have been informed in detail and prior to this amendment that considered that Enagás profile continues to be solid, Fitch has ratified our rating as A-, and Standard & Poor's has given the company a very solid rating, BBB+, equaling the level of other European comparable companies, such as NAM and Terna, and maintaining the best risk profile in the business, which is considered to be excellent. This operation improves the profit prospective of Enagás and reinforces the sustainability of our dividend for the long term.

To conclude, I would like to talk about our forecast for 2019-2023. As I already said in the presentation of results, the most important point is the sustainability of our dividend policy because the commitment with our shareholders is a strategic priority for Enagás.

Dividends will grow, fulfilling our commitment at an annual rate of 5% until 2020. And from that date onwards, our commitment is to continue to increase dividends by 1% or more every year until 2023. Our investment in Tallgrass reinforces that sustainability, the sustainability of our dividend, from 2020 onwards.

We have the foundations to continue to create value for our interest groups and stakeholders and to fulfill our commitments, as we have done in the last 12 years. These foundations are the following, you're well acquainted with them, with the first being financial sustainability of the gas sector. Since 2018, the gas sector in Spain has an annual net surplus, and this will allow to repay the debt before we foresaw -- before foreseen, in an environment of growing demand in which the natural gas demand in Spain since 2014 is growing above 4% per year.

Secondly, taking into account this operation in the U.S. that we have just presented to you, by the end of 2019, the current year, we will have invested around EUR 2.2 billion since we started our international activities in 2011 in brownfield projects.

And by the end of this period, this strategic update, that's to say 2023, the contribution of the results of our -- of the companies in which we hold stakes to the profit offshore practice will be around 40%. Both the regulated business in Spain as well as our international business contribute to generating stable, visible and predictable cash flows, which give us enough leeway to continue to grow in a sustainable manner in the future.

We have undertaken a strong effort in regard -- with regards to financial discipline that has allowed us to substantially reduce our indebtedness, specifically between 2017 and 2018, we have reduced our stand-alone debt by EUR 1.459 billion. And as we have said, now we have less accumulated debt than a year ago. Now we have a debt structure with more than 80% of the fix rate without any significant maturities in the short term and limited interest rate risk.

In the result -- in the presentation of results that we had a week ago, we showed a graph showing the cash flow generation for 2019-2023 period. Today, we present to you the same graph, but updated, the same chart, and you can see how the U.S. operation fits in with our strategy. You can also see and we kind of share that discretionary cash flows generated in the next 5 years, both by the regulated business as well as by the international business, will present enough leeway to ensure that we fulfill our dividend policy and, as I said, to continue to grow in a sustainable manner in the future.

The last pillar before we come to the end of this presentation is sustainability, which is a cross-cutting pillar for our strategy and our business model. We have approved this part of this plan. Our sustainability strategy -- the specific sustainability strategy for 2019-2021, which is aligned, on the one hand, and obviously with the strategic priorities of the company and also with the UN Sustainable Development Goals.

There are 3 key figures for us: energy efficiency and reduction of emissions; the role of natural gas and renewable gases in the energy model as part of the transition model towards a decarbonized economy; and obviously, people and corporate culture, trying to support quality jobs and attracting and retention of talent. All this while trying to maintain our leadership in the main sustainability indexes.



Conclusion. We can ultimately conclude that the strategy 2019-2023 has 6 headlines: Enagás' dividend will grow by 5% annual until 2020. From that year onwards and until 2023, we will continue to increase our dividend every year by 1% or more. This is something that I can confirm after having analyzed different profitable scenarios.

Second, cash generation forecasted for this period will allow us to pay the dividend that has been established, investing in new markets and businesses, while maintaining a solid balance structure.

Three, we have a debt structure with more than 80% of it as a fixed rate, thus limiting interest rate risks.

Fourth, we have the financial stability of the gas system and support in a growing demand environment.

Fifth, sustainability is, of course, a fundamental plan for the company's strategy.

And finally, the operation in the U.S. that we have just announced will contribute to sustainable growth for Enagás, in line with what's established in our strategy.

Our strategy is a mid- and long-term strategy, and our track record, the track record of Enagás, shows that it is right. [All the year] and the structural ups and downs of our space due to the evolution of the markets.

Thank you very much for your attention. I encourage you to ask any questions you consider adequate and, of course, we will try to respond them in the best detail possible. Thank you very much.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question by Javier Garrido from JPMorgan.

Javier Fernandez Garrido - *JP Morgan Chase & Co, Research Division - Head of Utilities and Senior Analyst*

I have several questions related to the Tallgrass investment. The first one is, could you give us details on the financial structure of the holdings through which you take your -- take all your stake in that holding? Or do you expect for that debt to be stable? Or is there any plan if you're going to have less debt? And what's your financing of the holding? The second question is regarding dividends that you expect to get from Tallgrass. First detail would be, could you give us more information about the taxes that you may have to be -- have to pay on the Tallgrass dividend -- Tallgrass -- for those dividends because Tallgrass doesn't pay taxes, what did -- where are we on those dividends? And do you expect for that -- those taxes to change with the government that we have in Spain that it wants to increase the taxes on dividends coming from abroad? So what are your forecasts for those taxes from those dividends that is coming from Tallgrass? Another question would be -- the one related to \$300 million additional that could be invested that you talked about, could you give us more details about how would you structure that possible additional investment? And what would that depend on if you were to invest more or less as Enagás there?

Antonio Lladen Carratalá - *Enagás, S.A. - Executive Chairman*

Thank you very much, JPMorgan, Javier. We'll ask the CFO, Borja, to reply to these 3 questions. You have the floor, Borja.



Francisco Borja García-Alarcón Altamirano - *Enagás, S.A. - CFO*

Thank you, Mr. President. Javier, the vehicle you referred to has a financial structure of \$1.1 billion. That loan has been granted by different banks. It's a syndicated loan that is already closed. It starts with a leverage ratio of around 3.5x, and that's a deleveraging -- a quick deleveraging until 2022. And that is -- the idea is to go back to the market in the year to recapitalize that vehicle. That's as for the question on the structure. As for taxes, due to the physical structure in the United States, the reception of dividends, and too, Enagás U.S.A. won't have to pay taxes. And if we want to repatriate those dividends to Enagás, we'll have a tax of 15%, of course, according to the applicable law. And finally, with regard to those \$300 million, that is the approval of Enagás' Board to analyze the participation in investment opportunities of these vehicles or that Tallgrass may have. Thank you.

Operator

(Operator Instructions) The next question will be asked by Carolina Dores from Morgan Stanley.

Carolina Botacini das Dores - *Morgan Stanley, Research Division - Equity Analyst*

I have 2 questions, actually. I am comparing the free cash flow chart that you presented, when you did the presentation of results compared to this current one. And there is an increase from EUR 3.156 billion (sic) [EUR 3.516 billion] to EUR 3.737 billion, EUR 221 million difference. And compared to Tallgrass, in Tallgrass, they have EUR 291 million. And I would like to know that EUR 70 million, what are they due to? My second question wants to extend on the answer that you gave to Javier, the debt of \$1.1 billion in this vehicle in which Enagás has 42% at the holding company, what is that issue? Those are my 2 questions.

Antonio Llarden Carratalá - *Enagás, S.A. - Executive Chairman*

Thank you very much, Carolina. Borja García-Alarcón will answer both questions.

Francisco Borja García-Alarcón Altamirano - *Enagás, S.A. - CFO*

Thank you, Carolina. I will start off by the second question because, indeed, I didn't say that before. That is very important. It's a nonrecourse debt to shareholders, and the recourse of those bad debt are actually the shares of the vehicle over the company. The changes in cash flow in the cash flow chart presented on this occasion compared to the one presented 2 weeks ago are due to mainly the contribution dividends of Tallgrass -- or sorry, the ones that we will receive in Enagás, which are on average EUR 60 million, they come from operation increase, which is EUR 44 million in average. And the difference between one and the other are the taxes that's paid by the debt -- for the debt that we banked in Enagás U.S.A., which is \$480 million, which is part of the equity that has been invested into the vehicle. There is an additional change, which is CapEx, the committed CapEx, which is an investment of EUR 591 million that were mentioned by the Chairman in his speech. And finally, we have [EUR 1.413 billion], which is the discretionary cash flow, which is a consequence, on the one hand, of that committed CapEx and also the funds from operations that I have just described. Thank you.

Operator

Next question by Javier Garrido, JPMorgan.

Javier Fernandez Garrido - *JP Morgan Chase & Co, Research Division - Head of Utilities and Senior Analyst*

I do apologize, just a clarification. As you talked about 15% of taxes, if you repatriate the dividends in your FFO hypothesis, are you assuming that those dividends will be repatriated? Or those dividends will stay at Enagás United States?



Antonio Lladen Carratalá - *Enagás, S.A. - Executive Chairman*

Borja?

Francisco Borja García-Alarcón Altamirano - *Enagás, S.A. - CFO*

Part of the dividends will stay in the United States to be -- to repay the loan of those \$490 million, and the rest will come to the cash of the Enagás International and Enagás S.A.

Operator

Ladies and gentlemen, there are no more questions in the Spanish channel. We are going to open the floor to the English

(technical difficulty)

Operator

The first question comes from Olivier Van Doosselaere from Exane.

Olivier Pascal Michel Van Doosselaere - *Exane BNP Paribas, Research Division - Analyst of Utilities*

If I may, I have 4 quick questions. First one is on the EPS impact. So you mentioned that you would equity account the acquisition of the stake in Tallgrass. It seems that the consensus EPS expectation is below that of the dividend. So would it be fair to assume that actually, on the P&L side, the contribution to earnings would actually be lower than the EUR 60 million dividend that you will receive from Tallgrass? Second question is speaking a bit more on the business of Tallgrass itself. What is your view on the upcoming maturities of take-or-pay contracts at Tallgrass? And is there any risk that maybe they will struggle to be renewed if they were maybe signed at a time when the prices were higher or given that the availability of shale gas now might make this gas coming from those pipelines may be less necessary? So could you please elaborate on the risk there? And then the third question, you mentioned that there was an idea to recapitalize the SPG at a later stage. So is there a necessity for Enagás at some point later on to reinject equity into the Tallgrass holding? And the last one, that's just a technical one, but you mentioned 1.1 billion of debt in the holding structure. Is that in euros or in dollars, please?

Antonio Lladen Carratalá - *Enagás, S.A. - Executive Chairman*

Thank you, Olivier. Borja García-Alarcón will answer these 4 questions.

Francisco Borja García-Alarcón Altamirano - *Enagás, S.A. - CFO*

Thank you, Olivier. Regarding the first impact, we have included the contribution of dividend, the dividend growth, for Enagás, EUR 60 million. Then we've got an impact, as we said, in the cash flow of the interest in the United States that leads us to funds from operation increasing by EUR 44 million as an average. And there, downward, the cash flow conversion into the P&L has got accountant impact that are relevant. The first accounting impact is [the purchase] price allocation that we're drafting, which is around EUR 15 million. And there is a difference in the accounting of the taxes versus the -- in the cash flow. So there, we cannot give you a fine-tune figure. But in terms of funds from operation, the impact at Enagás will be a comparative basis scenario without -- and with Tallgrass year-on-year, the funds from operation average will grow by 7%. Whilst this growth at the level of the result, because of accounting measures, will be reduced regarding earnings per share. The average life of contracts in Tallgrass is 10 years. The hypothesis we have assumed are -- in the models are consistent with the hypothesis of the market consensus. As the President has explained, the American market for mainstream growth at a major pace and where a part of that growth is for exporting oil and gas



in the future. So this asset will be part of those opportunities for growth. The recap I was referring to in the vehicle, that recap, any recap we might do will be in the exclusive benefit of the shareholders because the equity we have to contribute has already been contributed. So that recap, the amount of that debt increase will be in the form of extraordinary dividends for shareholders. And finally, the debt I was referring to is in dollars, \$1.1 billion. Thank you very much.

Operator

Thank you. Ladies and gentlemen, there are no further questions in the conference call. I now give back the floor to the company. Thank you.

Antonio Lladen Carratalá - Enagás, S.A. - Executive Chairman

Thank you very much, everybody. Thank you. The Investor Relations department, myself, the CEO and the whole team will remain at your disposal to answer any questions you may have in the coming days. And next week, we will start our traditional road show, therefore, we will have the chance to see many of you personally next week. And after the GSM, because everything is going to happen on the month of March, so after the GSM, we will resume our road shows. Thank you so very much, and thank you very much for your attention in a day that has many other things happening in other companies and the hiring of Zidane as coach of Real Madrid, which is possibly very interesting for many of you, too. So thank you very much, and have a good day.

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