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EDITED TRANSCRIPT

ENG.MC - Half Year 2019 Enagas SA Earnings Call

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PRESENTATION

Antonio Velázquez-Gaztelu - *Enagás, S.A. - Director of IR*

[Interpreted] Hello, good morning, everyone. Welcome to this results conference by Enagás that correspond to the first semester of 2019. First of all, I would like to apologize to you all for these technical problems that caused this delay.

As you all know, the results were published this morning before the markets opened. And Mr. Antonio Llarden is going to be present and Velázquez is to be leading this conference. The conference will last 15 minutes more or less, and then we will start with the Q&A session that we usually hold. So with no further ado, I will give the floor to the presenters.

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

[Interpreted] Good morning, ladies and gentlemen, thank you so much for your attention. As Antonio Velázquez-Gaztelu has just told you, the platform that organizes the conference call have had a technical issue that has fortunately been solved, and now we can begin.

I understand that the topic of most interest due to its importance is the situation of the regulatory purchase. And therefore, this will be the main focus of my intervention. Given that this is a call for results, I will, nonetheless, make a brief comment on the first half figures, which are positive and data with regards to natural gas demand, which are especially positive this year. The results for this first semester are very much in line with what the company expected and the market expected as well.

I would like to highlight 5 main points. The first one is profit after taxes, which stood at EUR 216 million in the half year, and it is in line with expectations for the end of the year. The second point is the excellent contribution from our investing companies, which already contribute nearly 30% of our net profit, profit after taxes. Now the third point is the good evolution that natural gas demand has seen during the first 6 months of the year, it has grown 9.4% compared to the same period in the previous year. And if we were to consider today's figures, this growth has already reached 13%. The fourth point is the strong financial position of the company. It's a solid position, with over 80% of our fixed rate debt and our financial cost of 2.1%, and with no significant maturities until 2022.

And lastly, the fifth point. During this half of the year we've invested EUR 645 million, which mainly correspond to our acquisition of an important stake in the U.S. company, Tallgrass. This investment reflects the importance of our international presence, reinforcing our dividend in both the medium and long term. As for other international matters, with respect to GSP, as always, I want to update the status of the situation to you. The arbitration that is -- that we maintain against the Peruvian state continues its ordinary course. We have already seen the arbitration panel form. This is the news and the procedure. And the first audience for the project will take place at the beginning of September.



As for the Trans Adriatic Pipeline, TAP, the degree of evolution of the project is 88.5%. And we consider that its commercial operation will begin along 2020. This will mean that during 2021, T-A-P, TAP will already contribute to our net profit, with around EUR 38 million in 2021. During that date, the international business will contribute over 40% of the group's net profit.

As for natural gas demand in Spain, as I've already said, it has grown this last few months, 9.4% compared to the previous year. Within this point, I would like to say that industrial demand continues its good performance with a 3.8% increase, setting a record high. There is no energy alternative for the industry in the short or in the medium term. And with regards to industry, which is one of Spain's economic levers, this is a great piece of news. The fact that there is an increase of industrial demand.

Now gas demand for electricity generation increased exceptionally by 65%, mainly due to lower hydropower generation, and this is a topic that obviously depends on the hydropower generation of the year but it is also due to a greater participation of gas and, what we call, thermal gas. So production of the electricity with thermal centrals instead of coal centrals or -- this replacing of coal has reduced the CO2 emissions by 24%.

In this occasion, we're going to update the demand forecast for 2019 that we provided you with at the beginning of the year. You know that we give you 2 forecasts. One in our first conference call, and then we update it during this call in June. So -- I'm sorry, in July. So if this trend is confirmed, we will close 2019 with an 11% growth in gas demand compared to the previous years, that would be an average.

In this context of strong demand, we are also at a moment of great use of Spanish gas infrastructure. We are regasing -- there is a regasification that is over the average of the last 5 years. And I wanted to tell you this to show the flexibility of the Spanish gas system. The world gas market's evolution and the spot market liquidity allow for a great LNG abundant, very competitive prices. And it also allows for Spanish regasification plants to consolidate themselves as a benchmark, as a reference. LNG tank stocks will reach in August, its maximum -- its technical maximum. And on the other hand, storage services also have an elevated number of contracts, 85%, and they're going up.

So let's talk about regulation now. Any update on the regulatory framework for energy in a European country must be fully aligned with the energy transition objectives towards a decarbonized economy. At Enagás, we are committed to these objectives, and these gas infrastructures have an irreplaceable role for sustainability and the reduction of emissions in the industry, heavy transport, and in other activities that have not yet become electrified. Furthermore, these infrastructures are essential as backups for renewable energies, and they are vital for developing renewable gases such as hydrogen, biomethane, et cetera, et cetera. So the CNMC draft circular of technical services, however, fails too much this vision. I'm not going to stop and go over the events that -- as they occurred, which you have in the presentation.

The most important highlights, on July 5, CNMC Technical Services published 7 circular proposals concerning electricity and natural gas. These regulatory proposals are for the electric system aligned with current course of electrical system, but yet come as an absolute shock to the gas system. In the current context of energy transition, the coordination of the electrical and gas systems is vital. We, therefore, need coherent regulations for the entire sector that will let us move forward in the energy transition and in the process of decarbonization. The CNMC proposals on -- endanger the stability of the energy system, and we think that are disconnected from the reality of the evolution of natural gas in the energy matrix.

Regarding Enagás more specifically, they proposed and accelerated the drop of the revenues of the company in an arbitrary way, without taking into account the gas infrastructure's key role in the current energy context. Therefore, they jeopardize the existing efficiency and the balance in the Spanish gas system. Enagás has a reasonable profitability, which is in line with other European TSOs, transmission system operators, from Europe. Profitability has to be measured, taking into account the future cash flows generated by an investment and not using a ratios fixed at a given point in time. Remuneration for the management of an infrastructure should be linked to 2 major parameters: efficiency; and the demand of transited gas.

As a second derivative, there are other indirect impacts that are very relevant. For example, they propose -- the proposals would place our gas company credit ratings at risk. And as you all are well aware, ratings are a key in a sector as capital intensive as the sector of energy. Beyond the context of these proposals, which, of course, have not yet been approved by the CNMC plenary, and I have to set this clear, technically, the CNMC works with its regulations, these circulars that have been published are really proposals of a technical service that have not been debated by the plenary of the CNMC, which is the ultimate body that is going to take the decision. So they have been published. And they are -- that's the phase that we're at.



So these process, in our belief, have been done too rapidly and without a formal possibility to have previous meetings with regulator before the publication of these drafts. This is what normally happens in these kinds of processes in the catches of our environment, this celerity would not appear to be necessary, given that the new sector regulation will not become effective until the year -- until January 2021. So before this situation, Enagás, first of all, is -- has had meetings and institutional contacts to explain the scope and the consequences of these proposals. We are working on drawing obligations that will include conceptual, legal and formal issues, framing them on the road map of an energy system that will be seeking decarbonization in a European Union context and its decisions, of course.

We are informing about the process evolution. First, with a relevant fact that we published when these drafts were published the same day. And in this results conference, we will not make constant declarations that will create confusion or noise. And we are also of course, working to be able to hold work meetings with the CNMC. The company will carry out all the necessary actions to defend its interests and those of all its stakeholders. So let me finish my talk with a few brief conclusions. First of all, our half year results are in line with the company and market expectations. The contributions of our investees already account for nearly 30% of our net profit after tax.

In 2021, the contribution from the international business will exceed 40% of the company's net profit. We clearly believe that in order for a TSO to maintain its efficiency and strength in the current context, it must have 2 complementary and clearly differentiated parts: one, the national regulated part; and the other, the international part. The good evolution of international business, together with a great effort and efficiency and our financial strength allow us to confirm the objectives that we have set out in our strategic plan until 2023. All of the objectives will be met.

Gas demand is performing very well, with a forecast of growth for 2019 of 11%. And this, of course, coincides with a time of high contracts and use of our infrastructures. That demonstrates the flexibility and the guarantee of supply of the Spanish gas system, which is one of the most efficient in Europe.

Sustainability remains a key element for Enagás and recently, we have obtained 2 new acknowledgments in this direction. We have renewed our presence on the FTSE4Good index. And we have been the first Ibex 34 -- 35 company to secure the A level of excellence in the work-family balance from the MásFamilia Foundation. So we are fully committed to the energy transition and the decarbonization objectives. In order to contribute in an effective manner, we need a consistent, stable and predictable regulation for the entire energy sector. We are working on our arguments against the draft regulatory circulars issued by the CNMC, putting all our efforts to reach a reasonable solution for everyone.

So thank you for your attention. And if you have any questions, please feel free to ask them. As always, we will endeavor to answer them as fully as we can. Thank you very much. So now we will open the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question by Fernando Lafuente, Alantra Equity.

Fernando Lafuente Seseña - *Alantra Equities Sociedad de Valores, S.A., Research Division - Research Analyst*

[Interpreted] Thank you for the explanation of the regulatory issues. I would like, if it is possible, to have a follow-up on that. I know that the company is actively working and defending its interests, but I'd like to know if you give us more details about what kind of actions, institutionally speaking, are being taken? Or you want to take in the coming weeks? And in line with that, I understand the proposals, especially for the Enagás activities, have a significant margin for maneuvers. So where do you think that these could be? How these proposals could be improved?

And the second question is in line with what you, Antonio, were saying on the international strategy. I understand that these kind of proposals of regulatory changes make for the international strategy to be more relevant. And I'd like to know what you think in that context about the direction or the company should take? Or what are the partners the company should be leveraging on? What -- I know that maybe it's too early to answer but maybe what are the first strokes that the international strategy is going to take on for the future?

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

[Interpreted] Thank you very much, Fernando Lafuente. Well institutional relations, including the CNMC relations we have had and we're going to have meetings, where above all, what we want to do is to explain how we see the scope of these drafts and how they affect not only Enagás, but the whole of the system and its stability, which, as I was saying in my brief intervention, it's -- it cannot be separated from the whole of the energy system. 30 years ago, the electricity system was different from the gas system, and they had no connection points, whatsoever. 20 years ago, with the combined cycles, we start to see that they have to be really be coordinated. And right now, not only in Spain, but if we want to move on towards a decarbonization process in order to produce less CO₂, we need to have that coordination of all the sectors, of the system. Improvements, of course, while we do think that efficiency must be the main engine, Enagás' track record in this sense is a successful story. So we're going to try for these aspects, these parameters to be -- that are clearly set, Enagás' profitability, well, we can contrast it with our European peers, we can benchmark. We are in the average, so -- with our peers. So it's a profitability that has no problems whatsoever. And finally, the objective, we will want to have of cheapening -- reducing the final prices. Let's recall, the tolls for transports are just 10% of the total cost of the infrastructures for the gas sector. And they are a minor part of the total cost of the energy invoice in Spain. And we have in our portfolio, possible proposals for technical measures and efficiency measures that we think can be very pertinent in this sense.

To your second questions, it's clear that we are talking about gas, and in these energy transition context, we're in a global market. So what's done country-per-country is not enough to move on in that direction. Gas is, right now, a global market. An example I could give you is our infrastructures right now are practically at full level in storage and regas, not because of an isolated Spanish decision, though we are consuming much more gas than last year, but this is fruit of a world movement with different elements that I cannot analyze right now. But we do think that our international expansion goes in that direction. We want to contribute with our modest experience and the efficiency we have. We've reached committing to go to stable markets with relevant growth in gas demand. And with a technical and legal context that are trustworthy. As you were saying, Fernando, it's not the time right now to go into fine-tuning details, but we are going to be focused on our international team to all the possible opportunities we may have. Thank you.

Operator

Next question will be asked by Alberto Gandolfi from Goldman Sachs.

Alberto Gandolfi - *Goldman Sachs Group Inc., Research Division - Head of European Utilities Research*

[Interpreted] I am Alberto Gandolfi from Goldman Sachs. I have 3 questions, 2 on regulation and then one on capital structure. The first question is, I understand that the process has been a bit weird without talking to the industry, but now there is a consultation period. And could you tell us what Enagás is asking for in a specific way? I mean could you tell if you're talking about RCS disappearing along 2 periods instead of just 1 or a higher return because objectively, 5.4% with this 10-year bond in Spain that is at 36 basis points, could not -- does not look so bad, since there aren't many investments that had to be done in Spain.

Now the second question is, could we think about a -- that position because in the active basis, is there any reason why we could be -- find it as too low? And then maybe, you could have a revision until November?

And the third question is, if the proposals of the CNMC are confirmed, what would be Plan B for Enagás? It seems that the President is focusing very much on the international strategy. A reduction of returns in Spain could accelerate that strategy and more -- especially, considering 2026 could start strategy -- could be achieved through an equity reduction and total transformation of the portfolio.

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

[Interpreted] Thank you very much, Mr. Alberto Gandolfi. Well, the first as well as the second question would force me to explain to you how we are preparing our arguments, which is something that I am not going to give. We have a few days to work on these arguments, on these allegations

and we want to mainly focus on those aspects that are technical aspects, as regard profitability, efficiency and functioning of the system and of a TSO that has over 25 years' experience, and we understand that, that is the basis to any argument, that is the basis for the discussion, and it is not the time right now to unveil what formulas we believe are the most important. And as a matter of fact, you said it at the beginning of your intervention, we would have liked to have a meeting previously with the CNMC because I am sure that an exchange of information would have been good, which is what I expect we will have when we present our allegations because that would allow us to clarify certain aspects of those regulations that are currently something that we do not agree upon and we could solve that. So once we have presented our allegations and once we have had working -- worked meetings with CNMC, then we will be able to give you an answer in detail.

And as for the international strategy, I have answered previously that I think that a TSO a transmission system operator, should have to fill it because the market leads TSOs to that position. I would say that currently, what worries me is regulation because it is somehow putting at risk the existence of the gas system itself, of the chain as it has been conceived. And Enagás is an important piece but just one piece of this gas system. It is not an isolated problem that affect only this company or some other company, we have to have a conversation on what the role of the gas system will be in the next 10 years, say, I mean obviously, the regulation considers 6 years, but we are thinking beyond that. We're thinking of 2030 horizon. So the conversation would have to go around this topic. And this is what we're presenting, so that we can have a larger vision, not just touching upon this or that data.

But as for the international strategy, it is clearly oriented, and we will provide you with complementary information when the time comes. And I would like to end this answer by highlighting something that I have explained previously, we maintain our strategic plan. Our plan is for 2019, 2023, amongst other reasons because the company is extraordinarily efficient because we have a solidity, a financial strength that is very important that not all companies have. And because it's also true because we are now challenging this regulation that is not finished, that is not completed. We are just challenging a draft. And this is a long road that we hope will bear some fruit so that we might find solutions for the whole system, not just for one company because that is not what we're fighting for here.

Operator

Ladies and gentlemen, there are no more questions in the Spanish channel. We shall now switch to the English channel. The first question comes from Harry Wyburd from Bank of America.

Harry Peter Wyburd - BofA Merrill Lynch, Research Division - VP and Junior Analyst

I've got 3 questions. These are mostly technical follow-ups to questions that have already been asked. So first one is, there have been reports in the press over the last few days, saying that the ministry is planning to refer the regulatory proposals to the so-called cooperation commission. And that apparently is equally composed of 3 members from the CNMC and 3 members from the government. But I wondered if you could clarify what is the end decision-making process for that cooperation commission? So for example, if the 3 governments appointees decide they want to improve the regulation and the 3 CNMC appointees decide they do not want to improve the regulation, then who has the final power to decide the outcome on that cooperation commission?

And then the second one is just on the CNMC Board, I believe many of the Board members of the CNMC are due for reelection in a few months, and also some of the technical staff have left. So please, could you just clarify what changes you expect on the CNMC Board? And what impact do you think will be from the fact that we still don't have a government in Spain and whether a new election could derail that process?

And then the final one is just on your domestic cost base, whether or not you have a worst-case scenario here, what in your view is the scope to make changes or efficiencies in your domestic cost base? Do you think there's a significant scope for cost savings here, if the regulator decides to enact these cuts in full?



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

[Interpreted] Thank you, Mr. Wyburd. The cooperation commission, as named by the Royal Decree of the beginning of 2019 is as all the process that we're living, it's the first time it appears, so we cannot give you examples that would explain what's going to happen in the future. What's clear is that in that Royal Decree, it is clearly said that in case of possible discrepancies between the ministerial authority, we can predict that way, and the independent authorities of the CNMC, what they create is this commission, created in a very precise manner to find -- to reach agreements. And what's not foreseen, is not to reach in their final agreement. We understand, therefore, that the work or works of these commissions will be the ones of debating, put an income on data and opinions and finding meeting points. Were they not to find them? Well, the legislation allows any of both parts to go to the courts. But I do understand the philosophy of the decree to create this commission in order to find solutions. That as far as the first question is concerned.

As for the second question, I cannot give you an answer. There's a formal process, perfectly defined on the duration of the mandates of the members of the commission. It is true that in a few months, some of these mandates will terminate. So in theory, it is foreseen to change them. It's going to be the first time that they change. So in theory, the procedures are the following: The government, when deems necessary proposals, a list of names, renowned people, that all will be submitted to hearings in the Economic Commission of the Parliament, a commission that I understand is created today or tomorrow. That's the normal procedure. So these people, men and women, the nominees are heard at the commission. Then there is a voting by the commission, that goes back to the government and the government proceeds to renew these chairs. That's the only thing I can tell you, that's the procedure foreseen in the law. But I insist, we have no previous examples, it's all new, so I cannot give you more details.

Finally, on the efficiency aspects. This is precisely one of the issues that we're going to introduce on our allegations. We do believe that depending on how regulation is set, paradoxically, it is possible to have more efficiency in the system or less efficiencies in the system, and this is one of the assets. I don't want to give you more details because this is -- something work in progress. It is one of the aspects that we're working on in our allegations. And we're convinced that we will be heard and we will be able to find a solution. Thank you, Harry.

Operator

(Operator Instructions) We have no further questions in the English channel, and we have new questions in the Spanish channel.

[Interpreted] Next question will be asked by Javier Suarez from Mediobanca.

Javier Suarez Hernandez - *Mediobanca - Banca di credito finanziario S.p.A., Research Division - Research Analyst*

[Interpreted] Yes, I am Javier Suarez from Mediobanca. I am sorry, if I'm asking a question that has already been answered because I had lots of problems with the conference. I wanted to ask, Mr. President, because I understand that there have been no conversations whatsoever until now with the CNMC.

Operator

[Interpreted] I'm sorry that the sound was lost, and we cannot continue with the translation. No sound is coming. I'm afraid no sound is coming to the interpreters' booth, and we cannot translate into English.

There is no sound coming the booth, we cannot -- the interpreters apologize, but there is no sound coming into the booth, as soon as the sound is reestablished, the interpreters will translate. Thank you.

Antonio Velázquez-Gaztelu - *Enagás, S.A. - Director of IR*

[Interpreted] Well, thank you all very much. We see that there are still some technical problems, we could not listen to the 2, 3 last questions because there is no connection. But since we do have the names of the people who asked the questions, we, from the Investor Relations department will

contact them, and we will answer their questions. We thank you all very much for your interest. And obviously, the Investor Relations department and myself will be at your disposal during these next few days if you do want some further information or clarify from topics. So thank you very much, and we will be in touch.

[Portions of this transcript that are marked Interpreted were spoken by an interpreter present on the live call.]

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