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ABY - Q2 2019 Atlantica Yield PLC Earnings Call

EVENT DATE/TIME: AUGUST 07, 2019 / 12:30PM GMT

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Praful Mehta *Citigroup Inc, Research Division - Director*

PRESENTATION

Operator

Welcome to the Atlantica's Second Quarter 2019 Financial Results Conference Call.

Atlantica is a sustainable total return infrastructure company that owns a diversified portfolio of contracted renewable energy, power generation, electric transmission and water assets in North and South America and certain markets in EMEA.

Just a reminder that this call is being webcast live on the Internet and a replay of the call will be available on -- at the Atlantica Yield corporate website.

Atlantica will be making forward-looking statements during this call based on current expectations and assumptions, which are subject to risks and uncertainties. Actual results could differ materially from the forward-looking statements if any of our key assumptions are incorrect or because of other factors discussed in today's earnings presentation or the comments made during this conference call in the Risk Factors section of the accompanying presentation on our latest reports and filings with the Securities and Exchange Commission, each of which can be found on our website. Atlantica Yield does not undertake any duty to update any forward-looking statements.

Joining us for today's conference call is Atlantica's CEO, Santiago Seage; and CFO, Francisco Martinez-Davis. As usual, at the end of the conference call, we will open the lines for the Q&A session.

I will now pass you over to Mr. Seage. Please, sir, go ahead.

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

Thank you very much. Good morning, and thank you for joining us for our second quarter conference call.

If we start on Page 3, we can see that we have continued showing a strong performance in the first half of 2019, where we have delivered growth in terms of revenues and further adjusted EBITDA, including unconsolidated affiliates on a like-for-like basis. Cash available for distribution, CAFD, also increased in the first half of 2019.

In the second quarter, we continued delivering on several strategic initiatives within our existing portfolio.

In first place, we have internalized operation and maintenance services in our U.S. solar assets. This initiative should deliver immediate additional CAFD even before considering any efficiency or cost savings.

Second, we successfully refinanced the project debt of our assets in Chile. As a result, we expect to increase the CAFD we obtain every year from these assets starting in 2020.

In third place, we signed our first ESG-linked financial guarantee line that will help us to progressively release restricted cash in some of our projects, as discussed last quarter.

Finally, we recently signed a $125 million limit increase for our revolving credit facility. Now the limit is $425 million, providing us with significant liquidity to continue growing accretively.

Finally, our Board of Directors has declared a quarterly dividend of $0.40 per share, representing an increase of 18% compared with the second quarter of 2018. The Board and management remain fully committed to dividend growth.

On Slide 5, we present our key financials. Revenues reached in the first half of the year $505 million, a 2% decrease, primarily due to currency translation effects. On a constant currency basis, revenues increased by 3% compared to the same period last year.

Regarding further adjusted EBITDA, it decreased by 7%. The decrease was due to currency translation effects again and a onetime noncash gain recorded in the second quarter last year. Excluding these effects, on a like-for-like basis, our EBITDA for the first half increased by 6%.

Finally, CAFD in the first half of the year increased by 5% year-over-year up to $94.5 million, in line with our expectations for the year.

Once again, the solid operating performance in the first half demonstrates the advantage of having a diversified portfolio, where a significant percentage of our revenues is based on availability and not only on generation.

Moving on to Page #6. We can see that overall, our portfolio delivered a good performance in the first half of the year.

Starting by geography. In North America, EBITDA decreased by 5%, mainly due to lower production from our U.S. solar assets due to lower solar radiation in the first quarter of the year. In the second quarter, EBITDA increased by 2%.

In South America, both revenues and EBITDA increased significantly, thanks to the continued solid performance of our assets and the contribution of the newly acquired assets in the region.

The revenue decrease in EMEA was mainly due to a currency translation effect. In Spain, production increased significantly, thanks to higher solar radiation. In our Kaxu asset, we continue to see a very strong operating performance.

Looking below at the results by business sector, we see similar effects. In renewable energy, revenue decreased due to the same currency translation effect and EBITDA decreased for the same reason and due to the extraordinary item I mentioned before. On a constant currency basis, revenue in renewables would have increased by 3% and EBITDA would have increased by 4%.

In efficient natural gas, the asset continues to show very solid performance, as you can see in that page.

And in transmission, revenues increased by 7%, with EBITDA growing by 8%, mainly thanks to a good operating performance and the contribution from the assets we recently acquired.

Finally, our water segment keeps showing a strong EBITDA levels.

If we look now at the following Page #7, we can see that electricity produced by our renewable energy assets increased by 14% versus the same period last year. Overall, our renewable energy generation assets delivered a strong performance in the first 6 months of the year.

Regarding our availability-based contracts, ACT continues showing solid performance. The scheduled major overhaul happened in the first half of the year, one turbine in Q1, the other turbine in Q2. And this explains the lower availability and production compared with the first half of 2018. Nevertheless, since the overhaul was scheduled, it did not have any impact on business or revenues.

Finally, in transmission lines and water, availabilities have been once more very high.

I will now turn the call over to Francisco, who will take you through the financial highlights.

Francisco Martinez-Davis - *Atlantica Yield plc - CFO*

Thank you, Santiago, and good morning to all. Let's move on to Slide 8 to walk you through our cash flow for the second quarter and for the first half of 2019.

Our operating cash flow for the first half of 2019 reached $149.1 million compared to $163.2 million in the first half of 2018, which included approximately $17 million corresponding to one-off payments received in Solana, with no corresponding amount in the first half of 2019, which explains the decrease. In the second quarter 2019, we generated a record operating cash flow for our second quarter of $52.2 million compared to $32.7 million in Q2 2018.

Net cash used in investing activities in the first half of 2019 was $119.4 million and corresponded mostly to investment in new assets and should be seen in conjunction with the net cash used in financing activity as it improves investments made by our partners.

Our net cash invested in new assets in the first half of 2019 amounted to approximately $40 million. Net cash used in financing activities in the first half of 2019 amounted to $84.4 million and included the impact of the refinancing of part of our corporate debt earlier this year.

All in all, the net change in consolidated cash for the first half of 2019 was a decrease of $54.7 million.

On the next slide, #9, we would like to review our net debt position. Our consolidated net debt as of June 30, 2019, is approximately $33 million lower than at the end of 2018.

We closed the first half of 2019 with net corporate debt of $582.6 million, in line with net corporate debt as of December 31, 2018. With this, our net corporate debt-to-CAFD pre-corporate debt service ratio stood at 2.5x. On the other hand, net project debt as of June 30, 2019, was $4,528 million, which is $38 million lower than at the closing of 2018.

I will now turn the call back to Santiago, who will review the progress achieved in the second quarter on some of our priorities.

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

Thank you. On Page 11, we can review the progress we have achieved on several initiatives within our portfolio.

In first place, we have internalized O&M services for our U.S. solar assets by acquiring the entity providing those services from our previous O&M supplier. Additionally, we intend to internalize part of the activities contracted in 2 wind assets, maintaining a direct relationship with the supplier of the turbine maintenance services. These initiatives will be accretive from day 1, thanks to the fact that we will avoid service fees even before considering any cost savings.

In addition, in the second quarter of 2019, we have refinanced the project debt of our assets in Chile. The new financing agreement is a U.S. dollar-denominated 12-year loan for a total amount of around $75 million with a group of local banks.

With this new project debt refinancing, we expect to achieve an average CAFD improvement of around $2 million per year going forward.

Third, as we discussed last quarter, we expect to be able to achieve our CAFD guidance in 2019 even if Mojave's distribution to us were delayed as a result of PG&E's situation. In this regard, Atlantica signed its first ESG-linked financial guarantee line to be exclusively used for renewable assets. We expect, in fact, to use this guarantee line to progressively release restricted cash in some of our projects. In any case, I'm talking about PG&E, the recent legislation in California is a very important step in the right direction.

And we believe that it highlights the probability of PG&E exiting Chapter 11 before June 2020 with no impact on existing renewable energy PPAs.

In fourth place, our strategic review committee continued working on the analysis of strategic alternatives to optimize Atlantica's value.

And finally, our recently announced acquisition of a 30% stake in Monterrey has recently closed as expected.

If we move to Page #12, you will see that our Board of Directors has approved a quarterly dividend of $0.40 per share for the second quarter of 2019 or $1.60 per share annualized. This represents an 18% increase compared with the same quarter in 2018.

Thanks for your attention. We will now open the lines for questions. Operator, whenever you want, we are ready for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Praful Mehta from Citigroup.

Praful Mehta - *Citigroup Inc, Research Division - Director*

So maybe just starting with the O&M contracts. Just wanted to understand, given what's been done so far and what you expect to continue to achieve around the internalization of these O&M contracts, what kind of CAFD benefits should we expect to see from a run rate basis, just so we can kind of build that into our models as well.

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

So what we have discussed today is the fact that we are -- we have internalized our U.S. solar contracts and we are working on a couple of wind assets. This is part, obviously, of our strategy to optimize our costs wherever we can. Going forward, we will see if we have more opportunities to do so. The financial impact of these 2 contracts, the 2 large ones in the U.S. and the smaller ones in the wind, is not a very significant amount, let's say, from $1 million point of view. The fees we are going to be saving probably are around $0.5 million per year or something. Additionally, there would be synergies and cost reductions that we will expect -- or we expect to get over time.

Praful Mehta - *Citigroup Inc, Research Division - Director*

Got you. Maybe secondly, on the strategic review side, I know that you're saying that it's still ongoing. Just wanted to understand, given the strategic review started more with where the stock was and how the PG&E uncertainty was impacting the stock and overall valuation, now that the stock has performed better, does the scope of the strategic review change in any way? Or how should we think about the strategic review now given where the stock is?

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

So my answer to your question would be no. The scope has not changed. From the very beginning, we said that the strategic review committee was about optimizing value. And that is what we have been working on and what we continue working on.

Praful Mehta - *Citigroup Inc, Research Division - Director*

Got you, fair enough. And that's an expected Q3, Q4 announcement?

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

So probably, without committing too much, but I would say that probably it's reasonable to expect some kind of communication before the end of the year.

Praful Mehta - *Citigroup Inc, Research Division - Director*

Got you. And just finally on the refinancings, given they have been successful so far, are there other projects where you believe that there are opportunities to refinance? And how should we think about that opportunity?

Francisco Martinez-Davis - *Atlantica Yield plc - CFO*

This is Francisco. We're always looking at the portfolio. Last year, we refinanced a couple of assets in Spain. This year, you saw that we refinanced the high yield on the corporate side. So yes, we're always looking at the existing portfolio to see where there is refinancing opportunities.

Operator

Your next question comes from Julien Dumoulin from Smith (sic) [Julien Dumoulin-Smith].

Julien Patrick Dumoulin-Smith - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

It's Julien here. So perhaps just to follow up on Praful's question, with respect to the strategic review, I just wanted to clarify a couple of things here. First, on optimizing value, when you think about the potential of asset sales specifically as one of numerous outcomes, how do you think about sustaining the dividend in that context and growing the dividend and basically finding a use of proceeds in any sort of a concurrent manner to keep the payout ratio, et cetera, intact, if that makes sense? And maybe you could speak to that specific route amongst other avenues being evaluated in the strategic review?

Francisco Martinez-Davis - *Atlantica Yield plc - CFO*

Okay. So as you can imagine, I should not be very specific regarding potential avenues. There are many ways to optimize value. You mentioned one of many. What I can tell you is that, as I mentioned during the call, our priority continues being to make sure that we will be able to grow our dividend going forward. And therefore, our strategy interactions should be consistent with that. Nevertheless, in the example, you mentioned, I think that both things you mentioned could be compatible, assuming that, that was part of our strategy or the things we did. So again, you mentioned one of the many options. And I wouldn't like anybody to believe that, that's what the strategic review is about, because it could be about many other things.

Julien Patrick Dumoulin-Smith - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

I'm just clarifying this. I mean with respect to the Board actions, et cetera, have we seen anything different on change of control or anything like that?

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

I didn't -- I don't understand exactly what you're trying to...

Julien Patrick Dumoulin-Smith - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

Just curious what the status of change of control, the payouts are with respect to any strategic outcomes.

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

I mean I don't see any change of control implications anywhere. And I don't know, Julien, what you're after exactly. So payout ratios are what they are. We don't have any change of control provisions beyond the normal ones in the corporate financing. I don't know if I'm missing something.

Julien Patrick Dumoulin-Smith - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

Or rather executive change of control.

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

Again, I don't know...

Julien Patrick Dumoulin-Smith - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

Okay. Fair enough. Just to bring it back to the core business real quickly. In focusing on that dividend payout ratio actually, could you elaborate a little bit further just with respect to your expectations for scale on dividend? Obviously, just $0.01 a quarter here increase. Do you -- it's tough to get ahead of the Board process here and evaluating dividends on a quarterly basis. But how do you think about continue to see the trajectory of the dividend increase even at $0.01 a quarter kind of trajectory here?

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

So as you know, the DPS growth target we have out there midterm is, let's say, a high single digit. And therefore, that's what we expect to be able to achieve in the midterm. At this point in time, with $1.60 on an annualized basis, our expectation would be to continue having a payout ratio similar to the one we have had lately, so call it an 80% or an 80-something percent, therefore not much new there. Our expectation is to continue having that kind of payout ratio by being able to grow the CAFD at a similar pace to growth in DPS using the target we made public some time ago.

Julien Patrick Dumoulin-Smith - *BofA Merrill Lynch, Research Division - Director and Head of the US Power, Utilities & Alternative Energy Equity Research*

Indeed, rather if I could clarify, just with respect to the $0.01 a quarter, could you see reacceleration, because obviously, that would imply closer to 3% off the current dividend. But I'm just -- this is more of a function of timing of asset acquisitions, et cetera, and cash deployment question mark?

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

So again, our objective is to be able to achieve the CAFD growth that we have out there. And therefore, there could be quarters with the number you mentioned and quarters higher and quarters lower.

Operator

And your next question comes from the line of David Quezada from Raymond James.

David Quezada - *Raymond James Ltd., Research Division - Equity Analyst*

My first question here on Kaxu. It sounds like operations have been going quite well there. Are you all the way there now in terms of where you expect to be with that asset? And can you just provide us any update, if at all, on when you expect distributions from that asset to start flowing?

Francisco Martinez-Davis - *Atlantica Yield plc - CFO*

So the asset has been performing very well for some time, and the performance we've seen in the last quarters are in line with our expectations. For -- and for 2019, we did expect distributions, and we have had distributions already.

David Quezada - *Raymond James Ltd., Research Division - Equity Analyst*

Okay. Great. And then on a follow-up question just on the ESG guarantee line. Any color you can provide on the pace of cash that can be moved off restriction going forward?

Francisco Martinez-Davis - *Atlantica Yield plc - CFO*

It is difficult to be very specific there. As we mentioned last quarter, this is part of our strategy to be able to compensate for Mojave distribution if they were delayed because of PG&E. And it will take time to release money from those accounts. So it will happen over the next few quarters. How many and at what pace is more difficult to foresee.

David Quezada - *Raymond James Ltd., Research Division - Equity Analyst*

Okay, okay. Fair enough. And then just my last question here. I wonder if you could just comment on how your development team has been doing? What you've been seeing in terms of the market for acquisitions in the regions where you've been focusing?

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

So in general, we are rather optimistic regarding that. At this point in time, we are working on a number of opportunities that we consider attractive. And the fact that we have been increasing our financing and the fact that we now have available a significant amount of funds, let's say, probably suggests that we expect to deploy some capital if we are able to close some of the opportunities we are working on, like always, with reasonable numbers.

Operator

There are no further questions at this time. (Operator Instructions) And we have no further questions at this time. I would now like to hand over to your host for closing remarks.

Santiago Seage Medela - *Atlantica Yield plc - CEO & Director*

Okay. Thank you very much to everybody. As always, you can reach out to our Investor Relations team if you want any follow-ups. Thank you. Bye.

Operator

That does conclude the conference for today. Thank you all for participating. You may now disconnect. Speakers, please stay on the line.
