



**Q1 2013 Snam SpA Earnings Conference Call
Transcript
24th April 2013**



Corporate Participants

- [Carlo Malacarne](#)
Snam SpA - CEO
- [Antonio Paccioretti](#)
Snam SpA – CFO

Conference Call Participants

- [Olivier Van Doosselaere](#)
Exane BNP Paribas – Analyst
- [Stefano Gamberini](#)
Equita SIM – Analyst
- [Sarah Laitung](#)
JPMorgan - Analyst
- [Edoardo Montalbano](#)
Centrobanca - Analyst
- [Roberto Ranieri](#)
Banca IMI - Analyst



Presentation

Operator [1]

Good day, ladies and gentlemen. Welcome to the Snam 2013 first quarter results conference call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Carlo Malacarne, the CEO. Please go ahead, sir.

Carlo Malacarne, Snam SpA - CEO [2]

Good afternoon, ladies and gentlemen. And welcome to the Snam 2013 first quarter result presentation. Today's agenda will be structured in two parts. First I will start by outlining the main highlights of the first three months and some recent developments. Antonio will then focus on the financial results for the first quarter in more detail. At the end of the presentation we will be pleased to answer any question you may have.

Let me begin with the main highlights for the first three months, as well a general update on the business. In the first quarter of 2013 we reported a good set of operating result despite a tougher economic environment characterized by declining gas demand. In addition, the first quarter results were also affected by some negative items concentrated in the period which will be diluted and recovered through the whole year.

The operating performance of Snam in the period is underlined by the EUR717 million of EBITDA, up 1.3% versus the same period of 2012. EBITDA growth was driven by an increase of approximately 3% in consolidated regulated revenues, net of pass-through components, partially offset by the growth of operating cost, which mainly related to the negative impact of the risk fund provision.

EBIT reached EUR531 million, a decrease of 1.3% due to the increase of depreciation and amortization, up 9.4%, mainly as the result of the new asset which became operational in the period. From a business segment perspective, the increase of EBIT in the storage business, up EUR12 million, was offset by the reduction in the EBIT in distribution, down EUR8 million, and in transport business, down EUR5 million. The 11.7% decrease in the net profit was mainly related to the higher interest expenses deriving also from the refinancing of our debt following the ownership unbundling from ENI.



Turning to the CapEx, in the first quarter of 2013 we executed EUR216 million investment, which were fully financed by cash flow from operations of EUR602 million. Furthermore, let me underline that around 70% of the consolidated CapEx was incentivized with a premium on top -- on the base return. This underlines the soundness of our growth path.

We continue to be strongly committed to maintaining a solid and efficient capital structure. As of the end of March 2013, Snam net debt was EUR12.1 billion with an average cost of debt of around 4%. Our commitment is once again highlighted by the recent bond issues of EUR1.5 billion that allow us a further optimization of our financial structure, lowering the average cost of debt while increasing both maturity and a fixed rate quota in line with our expectations.

Before concluding my presentation let me now provide you with a quick overview of the gas demand trend in Italy. In the first three months of 2013 gas consumption totaled 26.2 Bcm, down 4.8%, 1.3 Bcm year-on-year. The decrease was mainly driven by the reduction in gas consumption in the power generation sector. In particular the thermoelectric sector experienced a decrease of 16.3%, driven by the reduction of approximately 4.2% in electricity demand, mainly due to the negative trends in the macroeconomic environment, the remarkable recovery in hydro-related productions and the significant increase in electricity production from renewable sources, in particular solar energy.

These negative elements were only partially offset by a lower use of coal and oil product in thermoelectric production. Gas demand in the industrial sector decreased by more than 4% on a like-for-like basis as a consequence of the declining trend in industrial production in Italy throughout the period.

Gas consumption in the residential sector increased by 1%. This result was mainly due to the colder weather condition during last winter compared to the same period of 2012.

Finally, gas injected into the network for the first three months of 2013 decreased by 17%, 17%. And the difference between gas injected into the network and gas demand trend is related to storage flow. In particular the withdrawal activity in the period was significantly higher than the same period of 2012, plus 2.5 Bcm, mainly due to the lower gas import.

For the full year 2013 our current forecast is to account the gas consumption trend slightly better than the one accounting the first quarter. As far as gas volume transported, we expect on a full year basis a trend almost in line with the one forecasted for the gas demand, also then the positive contribution in the injection activity in the second and third quarter.



That's all for me. I will now hand you over to Antonio who will discuss our first quarter consolidated result in more detail.

Antonio Paccioretti, Snam SpA - CFO [3]

Thank you, Carlo, and good afternoon, everyone. Now I'm going to present the Snam first quarter 2013 consolidated financial results in more detail.

Looking at the consolidated income statement, EBITDA marked an increase of EUR9 million, up 1.3%, thanks to the growth of regulated revenues, net of pass-through, of all business segments, even in the difficult scenario that we have, together with the control of operating cost.

EBIT showed a slight decrease due to the growth of depreciation. It is important to underline that this increase is accounted in the third quarter, does not represent a reference for the growth in depreciation on a full year basis.

Net profit for the period showed a decrease of about 11.7% compared to the same period of 2012 to EUR242 million, reflecting the described increase in depreciation and higher financial expenses related to the increase of average debt in the period, and to the current financial structure which generated the effect of interest expenses starting from the fourth quarter of 2012.

Total revenues are in line with the first quarter 2012. If we exclude the pass-through components, regulated revenue posted an increase of EUR22 million, up 2.6%, thanks to the following elements. Transport revenues increased by EUR4 million even in the current scenario of declining gas consumption.

The positive contribution from the investments carried out in 2011 equal to EUR25 million was partially offset by the negative amortized adjustment of EUR5 million, and by the effect of the decrease of gas injected into the network of EUR12 million. The decrease in pass-through revenues is almost entirely due to the overall gas transport system balancing services.

Storage revenues grew by EUR13 million with a remarkable increase of about 10.4%, mainly due to the contribution from investments carried out in 2011. Distribution revenues increased by EUR9 million, mainly benefiting from the amortized adjustment of EUR11 million. Finally, other revenues amounted to EUR13 million with an increase of EUR2 million compared to 2012, mainly in the distribution business.



Moving to operating expenses, the total amount decreased by EUR10 million in the first quarter 2013, benefiting from the reduction of pass-through elements mainly in the variable costs. As far as controllable fixed costs are concerned, first quarter was in line with the same period of last year in nominal term, once again confirming Snam's ability to manage operating efficiencies. The EUR16 million increase in other costs was due to the dynamic of risk fund provision and to the evolution of the concession fees in the distribution activities.

Looking at the cost breakdown by activity, the cost reduction was concentrated in the transport segment, partially offset by the growth in distribution activities. Costs related to EBITDA amounted to EUR717 million, up 1.3% compared to the first quarter 2012.

Net of EUR185 million of depreciation, consolidated EBIT amounted to EUR531 million with a decrease of 1.3%. Looking at each business segment contribution, as far as Snam Rete Gas is concerned, the effect of the regulated revenues structure growth was offset by the weakness of gas injected and by the order and increase of depreciation.

STOGIT fully transferred the operating results structure to the operating results, the growth of regulated revenues, driven also by the investment carried out in 2011. ITALGAS growth of regulated revenues was upsid by the increase of depreciation and by the negative dynamic of risk fund provision.

Finally, the reduction of EUR7 million of Snam was the result of corporate not-regulated activities. As said, this quarter results were affected by some negative factors concentrated in the period, which will be diluted and recovered throughout the course of the year. Therefore, it is reasonable to think that the effect of these items will be negligible at the end of 2013.

Now I would like to conclude the review of the income statement commenting on interest expenses and taxes. Interest expenses grew by EUR40 million from EUR85 million to EUR125 million. If we exclude the effect of the accretion discount on risk and charges fund account in the period, the increase of interest expenses is about EUR30 million and reflected the growth of outstanding average debt, around EUR1.2 billion, as well as the increase of average cost of debt, reflecting the current financial structure cost of around 4%, compared to 3.3% in the first quarter 2012.

For the full year we expect that this difference in average cost of debt will be reduced thanks to on the one hand the progressive increase of the average cost during 2012 that reached the level of 3.6%, and on the other hand the optimization of the cost of the financial structure



in 2013. And the tax rate was around 42%, almost in line with the previous year, and therefore net profit decreased by 11.7% to EUR242 million.

Turning to the cash flow, in the first quarter of 2013 the Group generated an operating cash flow of EUR602 million, fully financing net investments for EUR342 million. As a result the cash flow in the period was equal to EUR260 million.

Looking at the cash components of the working capital, the cash generation was EUR193 million, mainly due to the increase of tax payable of around EUR204 million relevant to the profit before tax accounting in the quarter. Moreover, the first quarter 2013 accounted a growth of payables to Cassa Conguaglio of about EUR136 million, relevant to the transport and distribution businesses, offset by the payment to ENI of EUR141 million related to the balance of the consideration for the unwinding of interest rate swap.

Turning to CapEx, in the first quarter 2013, consolidated CapEx gross of subsidies amounted to EUR260 million, 16% down compared to the same period of 2012. Capital expenditure for the transport and regasification businesses was EUR95 million, around 45% of the total.

It was highlighting that around 76% of the total amount is incentivized with a premium that varies from 1% to 3% on the base remuneration. In particular, around 40% of transport CapEx was on expansion projects and new entry points, and was therefore remunerated with a premium of 3%.

Investments in the storage business in the first quarter 2013 amounted to EUR50 million, representing around 23% of consolidated Group investments. Around 92% of the storage CapEx received 4% in [extraordinary] remuneration for eight or 16 years.

Moving to the distribution, CapEx amounted to EUR69 million. Around 13% of ITALGAS CapEx was related to cast iron replacement with a targeted return at 9.7%, while 25% was related to metering with a targeted return rate of 8%. CapEx related to distribution business represented around 32% of Group capital expenditure.

Let's now move to the balance sheet. Fixed assets increased by EUR161 million versus yearend 2012. This was mainly due to the new investments of EUR260 million, the reduction of CapEx payable of EUR154 million, partially offset by the depreciation of EUR186 million in subsidies for about EUR21 million.

Total net financial debt amounted to EUR12.138 billion, down EUR260 million versus yearend 2012, thanks to the cash flow from operation generated in the period, EUR602 million, only partially reduced by the net investment for EUR342 million.



Thank you very much for your attention. We will now be pleased to answer any questions you may have.

Questions and Answers

Operator [1]

Thank you. (Operator Instructions). We will now take our first question from Olivier Van Doosselaere from Exane. Please go ahead.

Olivier Van Doosselaere - Exane BNP Paribas - Analyst [2]

Yes. Thank you very much, a couple of questions on my side, firstly one coming back to the cost of debt, if you could maybe give an indication what you now expect as a cost of debt for the full year 2013, taking into account the potential renegotiations that you could do with your lenders.

Secondly, you indicated that the depreciation for this year -- or for the first quarter shouldn't be taken as the rate for the full year. So maybe I was wondering if you could give an indication what to expect on full year total depreciation.

And then also, finally, maybe more in general on dividend policy we are seeing some consultation documents suggesting potential risk of cuts on your regulation. I was just wondering to what extent the dividend policy could actually come at risk if there is a risk on EPS, so maybe if you could give an indication on what you see as a possible long-term, sustainable payout policy. Thank you.

Antonio Paccioretti - Snam SpA - CFO, Financial Reporting Officer [3]

I will start from the question in relation to depreciation. I think that the most, the simplest way in order to answer your question is to give you a guideline in relation to the expected increase in depreciation during this year.



I think that a reasonable guideline for this amount is of an increase of around EUR40 million. You can understand that if you compare this amount for the full year basis and the depreciation, the depreciation increase we accounted in the first quarter that's why we cannot -- we are saying that there is no and -- you don't have to multiply by 4 this amount. So we expect to have an increase in depreciation of around EUR40 million.

For the cost of debt, what we have done so far this year is to replace one facility we had signed and raised in June last year. I'm talking about the facility, the term loan of five years -- of the original five years tenor of around EUR1.5 billion. And we repaid such facilities with the proceeds of the two bonds we executed at the beginning of April.

In terms of the yield of the two tranches was around 2.4% for the four year's tranche in the amount of EUR1 billion, and 3.4% for the second EUR500 million tranche of around eight years. The rationale of the transaction was for sure to reduce the spread and to have a reduction of the spread, which take into account of the one that we paid and for the terms loan, for the term loan. The saving, in terms of spread we had, and we will have in the future, is at least in the level of 160 basis points.

The -- on what we have done anyway is to invest part of this benefit for the fixed rate for having a fixed rate and for having an increase of the fixed rate portion of our total debt, and for having longer maturities in order to reduce the financial risk implied in our financial structure.

All in all, this savings was one-third of the saving I was mentioning before has been invested for interest rate and for the fixed interest rate and for the longer tenor. And therefore we can say that on the EUR1.5 billion for we have -- we will have net of this new investment a cost -- a reduction of cost of around 1%. On a full year basis it means around EUR50 million.

You know that we are discussing -- we are managing the rest -- the other financings that we concluded with the banking system last year. It is part of our ordinary exercise for managing our cost of debt. I think that, believe that soon we will reach a final agreement with our friends of -- the lenders of the banks.

All in all I think that considering the savings we already realized for the retainer of the term loan and the savings we are discussing for the other facilities in pool, a guideline for the reduction of interest rate is something between EUR30 million and EUR40 million per year.



Carlo Malacarne - Snam SpA - CEO [4]

The first question, I confirm the guideline for the dividend per share of 2013. And I don't see a risk of the sustainability of our dividend per share.

Olivier Van Doosselaere - Exane BNP Paribas - Analyst [5]

Okay. Thank you very much.

Operator [6]

Thank you. We will now take our next question from Stefano Gamberini from Equita SIM. Please go ahead.

Stefano Gamberini - Equita SIM - Analyst [7]

Yes. Good afternoon. I have still a question regarding the new regulation considering if you can elaborate a little bit and if you can give your opinion on the new regulation, and in particular regarding the lowered return. The regulators set a range for the beta between 0.21 and 0.36, so lower compared your previous one, and electricity transport level, as well as the leverage this should be between 80% and 110%.

In the worst case scenario assuming the final decision will be for the lowest range, my estimated calculation of the lowered range could be in the range of 5.2, 5.3, assuming a 10-year bond, a 10-year government bond in the region of 4.3. So I have the same question; even in this case with such a low return you expect that the EUR0.25 could be confirmed even in doing the -- your CapEx business plan [here] to 2016.

The second is if you have a guidance for the CapEx plan in the year and also for '14, as well as if you can comment also on the returns, and so in turn the proposals the regulator on the extra returns for two years on new investments, and then to change the system for the following year, so related to the benefits for the system on the investments, many thanks.



Carlo Malacarne - Snam SpA - CEO [8]

For the first questions, and frankly speaking I don't want to comment in detail on a preliminary consultation document. We have time by October to comment all the figures. And you know we expect another consultation document.

I can say that the consultation document and the consultation paper for the transport business is today confirmed the stability of the regulatory framework. And frankly speaking considering the preliminary consultation document, the document is in line with our expectation.

I can add, in the second question that concerning the treatment by -- of the new investment I think that some innovative approach are proposed from 2016. And the new scheme would represent, could represent let me say a positive aspect considering that the categories of incentivizing investment perfectly fit with the target of our strategy and with the projects which are at the core of our investment plan.

For the second question, for the CapEx let me highlight that I think it is not appropriate to comment on a quarterly basis the CapEx trend, the spending during the year. So we'll floating considering the execution of the construction phase.

By the end of the year we confirm the spending of EUR1.3 billion. In 2014, as I said in February in the February presentation, we estimate roughly the same investment, EUR1.3 billion, EUR1.4 billion. And we'll have the [Peco] investment of EUR1.7 billion and EUR1.8 billion in 2015 and '16. Only to confirm that in the first quarter the delay, if you can speak about the delay, but the delay is only due to a delay of the raw material supply during the first three months of 2013 without impact in the construction phase during the year.

Stefano Gamberini - Equita SIM - Analyst [9]

Thanks.

Operator [10]

Thank you. And we'll now take our next question from Sarah Laitung from JPMorgan. Please go ahead.



Sarah Laitung - JPMorgan - Analyst [11]

Hello. And yes I just have some more questions about the consultation paper and the transport regulation. I was wondering if you agree with the authorities' reasoning on why gas should receive a lower premium to compensate for the time lag than electricity? And I understand that the proposal is for a 50 basis points premium rather than 100 basis points in electricity. And I'm just trying to understand why that should be the case and whether you agree with that.

And secondly, on distribution are you still expecting the next paper around the end of June? And then do you see any read across from the transport proposals, in particular the beta and the leverage assumptions for distribution?

Carlo Malacarne - Snam SpA - CEO [12]

For the time lag compensation let me say, I repeat, this is the first, the preliminary consultation document. And we have all the time to discuss not only the figures, but the methodology and the returns of the total investment. So I don't think that is appropriate to comment a specific figure today without understanding the general comment of the operators about this type of document. But frankly speaking it's not outside -- in general it's not outside the framework of the consultation document, outside our expectations.

We expect the consultation, the second consultation by I think July, end of July or in the summer period for the distribution. But considering the first consultation document, the framework of the document I think will remain in place, and was let me say positive the understanding process, and the stability and visibility in the distribution business considering the proposal of the extension of six years. So I think it will be positive.

Operator [13]

(Operator Instructions). We will now take our next question from Olivier Van Doosselaere from Exane. Please go ahead.



Olivier Van Doosselaere - Exane BNP Paribas - Analyst [14]

Yes, hi, sorry just one question I hadn't as asked before, but if you could come back and actually explaining the drop in EBIT at ITALGAS. I understand there are high depreciation, but you would see that also going on with higher revenues. So you mentioned also that there was something there of risk fund provisions. Could you please detail actually what actually happened there? Thank you.

Antonio Paccioretti - Snam SpA - CFO, Financial Reporting Officer [15]

In general terms I would say that in this period we accounted the effects of certain factors which on revenues and costs are concentrated in the first quarter, but again would be diluted and recovered during the year. In particular I am referring to items related to depreciation and the risk fund provision together with the lower revenues due to the lower volumes transported.

All in all in the first quarter such effect represents 7%, 8% of our EBIT. On a full year basis this component would be reduced to 1%, around 1%.

In particular in relation to the distribution, the increase in other costs which is something close to EUR50 million is in mainly due to risk fund provision related to the so-called the energy efficiency certificate, in the distribution again, that we expect having a higher cost than in the past.

Olivier Van Doosselaere - Exane BNP Paribas - Analyst [16]

Okay. Thank you.

Operator [17]

Thank you. We will now take our next question from Edoardo Montalbano from Centrobanca. Please go ahead.



Edoardo Montalbano - Centrobanca - Analyst [18]

Hey, good afternoon, one question on Isontina Gas, the Italian antitrust stopped the deal, if you can give a comment on this decision and if you have an alternative plan for the concession tenders in this area. Thank you.

Carlo Malacarne - Snam SpA - CEO [19]

But the comment is -- the operation of the Isontina Gas in our strategy you remember was the possibility to consolidate the distribution market with some synergy from Snam, from ITALGAS and from the municipality. So it was very clear that the concentration give us the possibility to manage an entire distribution area with a strong capability of synergy.

Anyway, on April 17 the National Competition Authority has resolved not to authorize the transaction consisting in the acquisition of the 50% of Isontina Gas together with Acegas. The transactions which was conditionally subject to the obtainment of the National Competition Authority, was stopped since the authorizations anyway.

The reason explained by the National Competition Authority was the possibility with the operation to create a dominant position of Isontina Reti which would substantially and durably let me say impede the [restrict] competition in the relevant markets of the future tenders for the concession of natural gas distribution service in the local areas of Gorizia, Trieste, Pordenone and Padua 1.

It's clear that ITALGAS does not share the IGCM decision and the conclusion of the authority. And ITALGAS adopts the necessary action to defend its interest.

Edoardo Montalbano - Centrobanca - Analyst [20]

Okay, thanks.

Operator [21]

Thank you. We will now take our next question from Roberto Ranieri from Banca IMI. Please go ahead.



Roberto Ranieri - Banca IMI - Analyst [22]

Yes, good afternoon, gentlemen, two questions please. The first one, forgive me, but just a follow-up question on regulation and the new consultation paper, and specifically I would like from you a clarification on one of the main items, a component on the WACC calculation. It is true that as far as I remember the -- okay, the consultation paper is proposing a beta unlevered in the range of 0.21 and 0.36, so two questions.

The first one is, this range is the unlevered?

And the second question is, is this -- I suppose that the, as far as I remember, the beta levered would be used for WACC calculation. So basically I suppose that the beta to be considered would be higher than this one.

And then that's the first question and it is a clarification from -- on methodology, so I suppose nothing has changed about that.

My second question is about the distribution business and if you can give us an update on the process of the bidding, the bidding process, the bidding pipeline for ITALGAS and if you will [draw back] on distribution concessions acquisition for the rest of this year. Thank you very much.

Carlo Malacarne - Snam SpA - CEO [23]

Okay. I'm so I'm starting with the second questions. For the second questions today we don't have a signal, let me say, of the starting process of the preparation of the call for tenders by the municipality. I remind you that one-third, more than one-third of the ITALGAS concessions today are not subject to considering their own municipality; and some concession, they expire beyond 2019, is not subject to the bid for tender.

Anyway, we are preparing all the process of collecting the data. But frankly speaking I don't have a signal of a starting process for the new bid. I don't expect that during 2013 the process will start very, let me say, very quickly. And I imagine, I think that we need more than four years to complete or to complete or anyway to have some result from the consolidation market in the distribution.



It is clear that we are ready. We are monitoring the market, but the rules today set I think give -- don't, let me say, create the clear condition to start with the call for tender from the municipalities.

Antonio Paccioretti - Snam SpA - CFO, Financial Reporting Officer [24]

Roberto, in relation to this point the beta levered, unlevered and so on, as you, we have been analyzing the content of the consultation document since Monday evening, with -- the content is same as that you are the possibility to read too. And therefore let me say we prefer to have some time for understanding in details the content of the document, beta levered, unlevered. I think that we will have the time for understanding better the different indications.

I understand. It seems to me to want to remember that when there is an indication of range for the beta from the current one to the lower one it is referred to the unlevered beta.

Roberto Ranieri - Banca IMI - Analyst [25]

Thank you.

Operator [26]

(Operator Instructions). As we have no further questions I would like to turn the call back to Mr. Malacarne for any closing or additional remarks.

Carlo Malacarne - Snam SpA - CEO [27]

Okay. Therefore as there are no more questions, thank you, everyone. And have a good afternoon. And bye-bye to everyone.

Antonio Paccioretti - Snam SpA - CFO, Financial Reporting Officer [28]

Thank you, bye.



Operator [29]

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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