



Q3 2014 Snam SpA Earnings Conference Call

Transcript
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Conference Call Participants

- [Alberto Gandolfi](#)
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Presentation

Operator [1]

Good day and welcome to the Snam 2014 third 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, CEO. Please go ahead.

Carlo Malacarne, Snam SpA - CEO [2]

Good afternoon, ladies and gentlemen, and welcome to Snam's 2014 third quarter results presentation. Today's agenda will be structured in two parts. First, I will start by outlining the main highlights of the nine months and some recent developments. Antonio will then focus on the financial results for the first nine months in more detail. At the end of the presentation, we will be pleased to answer any questions you may have.

Let me begin with the main highlights from the first nine months, as well as giving you an update on the business. For the first nine months of 2014, I am pleased to report a solid set of results consistent with our track record of delivery and in spite of a tough environment.

Snam's sound operating performance over the period is reflected by the EUR2.648 billion of revenues and EUR2.111 billion of EBITDA, both up around 1% versus the same period of 2013. The increase in consolidated EBITDA was achieved due to the growth in regulated revenues across all our businesses and our continued focus on the control of operating cost.

EBIT reached EUR1.528 billion, up 0.8% versus the same period of 2013, supported by the solid contribution of all our activities. This is a remarkable result considering that 2014 is the first year of the full regulatory period for transmission, regasification, and distribution business.

Leveraging the solid operating profit, the significant increase of 28% in net profit is also the combined result of lower interest expenses during the period, the higher contribution from our associated, the reduction of the tax rate.

Turning to CapEx, in the first nine months of 2014, we executed EUR856 million of investments, up 10.5% versus the same period of last year. Around 75% of the consolidated CapEx received a remuneration higher than the base return. The level of CapEx achieved in



the first nine months give us confidence to confirm the full-year guidance of EUR1.3 billion of spending.

The cash flow from operations of EUR1.1 billion, fully financed the overall CapEx generating a positive free cash flow of EUR212 million. This underlines the soundness of our growth strategy and our commitment to maintaining solid and efficient capital structure. As of the end of September 2014, net debt was around EUR13.7 billion.

During our last strategy presentation, we outlined the main goals of Snam international strategy in detail. To summarize, they are optimization of returns from our existing asset base by using the investment optionality that is provide us; the coordination of CapEx and commercial activities in the context of our cooperation with Fluxys in the north-south corridor with the goal of providing integrated management of the asset; focus on completing our presence in the east-west gas corridor.

The agreement with Cassa Depositi e Prestiti for the acquisition of 89.2% of TAG perfectly fits with the Snam development strategy abroad and further strengthens the Company's leading role amongst infrastructure operators in Europe. The TAG pipeline, also due to its potential use in [reverse flow] toward Central Europe market, is a strategic asset for the development of the European east-west energy corridor in the broader context of the increasing integration of continental energy networks.

TAG has an overall length of about 1,140 kilometers, and its operations are entirely subject to Austrian regulation. The current regulatory period will last until the end of 2016. And our revenues largely derives from long-term ship-or-pay contract expiring in 2022, which ensures a high level of cash flow visibility.

In more detail, the deal with the CDP involves the acquisition by Snam of 84.47% share stake, corresponding to 89.22% of economic rights, which is presently held by CDP Gas, a fully owned subsidiary of CDP. Gas Connect Austria will hold the remaining 15.33% of the share capital and 10.78% of the economic rights.

The total consideration for the stake is equal to EUR505 million, which will be paid with a share capital increase fully reserved to CDP Gas. The deadline for the closing of the transaction is set for March 2015, but we are working hard in order to complete the deal by year end. This is the purpose Snam extraordinary shareholders' meeting is convened on next December 10th for the approval of the share capital increase.

The share capital increase allows Snam to strengthen its capital structure, increase its financial flexibility, and preserve its profitability. In this respect, we expect the deal to be EPS accretive starting from the first year. The contribution of TAG will be consolidated at equity



level as the corporate governance rules determine joint control between Snam and the local Austria partner Gas Connect in Austria.

Before concluding my presentation, let me now provide you with a quick overview of gas demand in Italy, focusing on weather-adjusted data, which better represents the overall trend, considering the unusual mild weather condition experienced during last winter.

In the first nine months of 2014, gas consumption totaled 47.1 BCM, down 4.4% versus the same period of last year. The decrease was mainly due to the 14.8% reduction in gas consumption in the [terminating] sector driven by a reduction of 3% in (inaudible) demand, 7 -- down 7.6 terawatt hour, mainly due to the negative trends in the macroeconomic environment.

The 10% increase in hydro-related production's up 4.4 terawatt hour due to the higher level of rainfall. The increase in electricity production from renewable resources, mainly solar, up 1.8 terawatt hour, as well as the 3% increase in the electricity import, approximately 1 terawatt hour. These negative elements were only partially offset by a lower use of coal and oil products in the terminating production.

Gas demand in the industrial sector decreased by approximately 1% on a like-for-like as a consequence of the declining trend in industrial production in Italy throughout the period. Gas consumption in the residential sector decreased by approximately 17.5% or 3.7 BCM. This result mainly -- was mainly due to the mild weather conditions last winter compared to the same period of 2013. Adjusted for the weather effect, consumption level in the sector were almost in line with the same period of last year.

Finally, gas injected into the network for the first nine months of 2014 was down by 6.2%. The decrease was driven by the reductions in gas demand, which was partially offset by the positive change in storage flow.

That's all for me. I will now hand you over to Antonio, who will discuss our consolidated results for the first nine months in more detail.

Antonio Paccioretti, Snam SpA - CFO [3]

Thank you, Carlo, and good afternoon, everyone. Looking at the consolidated income statement of the first nine months 2014, EBIT amounted to EUR1.528 billion, up 0.8%, [a nonnegligible] increase if you consider that 2014 is the first year of the new regulatory period for transport, distribution, and reclassification activities.



Moreover, net profit increased by around 28% to EUR863 million, benefiting from the significant reduction in our average cost of debt, reflecting the debt optimization measures carried out so far; the increase in income from associates, driven by the positive contribution of TIGF, and the nonrecurring positive item related to the equity interest in AES Torino; the reduction of the tax rate, mainly related to the Robin Hood tax.

Starting from July the 1st, AES Torino, the gas distribution company operating in Turin, is consolidated in our accounts as the part of the distribution business segment.

Total revenues of the first nine months 2014 amounted to EUR2.648 billion, showing an increase of EUR15 million. Regulated revenues net of passthrough components increased by EUR20 million, up 0.8% compared to the same period in 2013, reflecting the following contributions by business segment.

Transport revenues marked an increase of EUR10 million. The positive contribution from the investment carried out in 2012, equal to EUR64 million, was partially balanced by the tariff adjustment of EUR45 million and the effect of the decrease of gas injected into the network of around EUR9 million.

Distribution revenues grew by EUR6 million, mainly reflecting the slight reduction in regulated revenues following the new regulatory period, offset by the contribution of the consolidation of AES Torino from July the 1st, equal to around EUR17 million.

Storage revenues increased by EUR7 million, mainly due to the contribution of investments carried out in 2012.

The decrease in passthrough revenues was mainly due to the overall gas transport system balancing service. Other revenues amounted to EUR45 million, an increase of EUR15 million compared to the same period of 2013.

Moving to operating expenses, total cost of EUR537 million registered a decrease of EUR13 million, mainly related to variable costs and passthrough elements.

Controllable fixed cost of the first nine months 2014 amounted to EUR348 million, an increase limited to EUR12 million compared with the same period in 2013. This confirms our attention to cost control, even considering the incremental cost related to AES Torino of around EUR4 million.



Variable costs reduced by EUR10 million, both in the distribution transport businesses, while the decrease in passthrough cost was mainly due to the overall gas transport system balancing services. Nonregulated costs amounting to EUR19 million decreased by EUR6 million, mainly in the distribution business.

Moving to the cost breakdown by business, net of passthrough costs, we can highlight a growth of EUR13 million in the transport business, mainly related to [risk on] provision and the reduction of EUR9 million in the distribution businesses.

Consolidated EBIT amounted to EUR1.528 billion, with an increase of EUR12 million, up 0.8%, which was the result of the increase in regulated revenues of EUR20 million, and the other positive effects of around EUR20 million, mainly reflecting the reduction in variable costs and the positive contribution from nonregulated activities, partially offset by the already commented increase in controllable fixed costs of EUR12 million and decrease in depreciation and amortization of EUR16 million, mainly due to the new assets starting into operation.

In terms of business segment, let me underline the contribution of storage business that registered an EBIT growth of EUR24 million, up 10% compared to the same period in 2013. For the transport and the distribution businesses, the operating margins are substantially in line with the previous year, a remarkable result, considering that 2014 is the first year of the new regulatory period.

Concluding the review of the Group's income statement, net profit for the period was EUR863 million, up 28%. In addition to the EBIT increase, net profit growth was supported by, firstly, the decrease in interest expenses of EUR62 million, mainly due to the lower average cost of debt, down around 50 basis points to 3.3%. Debt benefited from the significant debt optimization measures carried out so far, partially offset by the higher average outstanding debt and some upfront fees accounted last year following the repayment in advance of a term loan financing subscribed in 2012.

Secondly, the increase in net income from associates of EUR91 million, due to the higher contribution from -- of TIGF for about EUR50 million, which as you know last year was negatively affected by a tax burden related to the acquisition, and a EUR51 million one-off positive item resulting from the restatement of AES Torino equity interest at its fair value. Following the acquisition of the residual stake in the company, AES Torino is 100% owned by Italgas starting from July the 1st.



Thirdly, the reduction of the tax rate to around 36%, mainly due to the decrease of the Robin Hood tax to 6.5%. Please note that this level of tax rate is influenced by the nonrecurring positive items related to AES Torino, which is fiscal neutral. Therefore, we can confirm the expected tax rate of around 37%, 38% for the full year.

Now, let me give you the update on the progresses achieved on our debt structure. The first nine months of the year have been characterized by a further access to the capital markets via public issuance and private placements, for a total amount of EUR1.25 billion as at the end of September 2014.

In addition, at the same time, at the same date, in order to extend the maturing and reduce the cost of the financing, Snam performed bilateral and pool banking facilities renegotiation for an amount of debt of around EUR3.6 billion and finalized the disintermediation of certain European investment bank financings for EUR300 million.

These factors made it possible to achieve an average cost of debt of about 3.3% in the first nine months of 2014, which paves the way to reach the level of 3.2% for the full-year 2014.

Let's now move to the cash flow. In the first nine months of 2014, the Group generated an operating cash flow of EUR1.095 billion, fully financing net investments of the EUR883 million, and resulting in a positive free cash flow of EUR212 million.

After the payment of the 2013 dividend balance and the consolidation of net debt for around EUR115 million, the increase in net debt at the end of the period was equal to EUR408 million.

Looking at the change in working capital, the cash absorption of EUR243 million was related to around 50% to the payment of the nonstructured trade payables accounted at the year-end 2013, while the remaining part was due to the building seasonality that will expect to be absorbed, therefore not impacting the change in working capital forecasted at the end of the year.

Finally, turning to the balance sheet, fixed assets increased by EUR443 million versus year-end 2013. This was mainly due to the new investment of EUR856 million, the reduction of CapEx payable of EUR67 million, and was partially offset by the asset depreciation of EUR583 million and subsidies of around EUR51 million.

As regards investments of the period, EUR445 million are related to the transport and gasification businesses, around 50% of the total; EUR232 million refers to distribution



activity; and EUR175 million to storage. Around 75% of deconsolidated CapEx receives a remuneration higher than the base return. As usual, further details on the CapEx are provided in the annex of the presentation.

Total net financial debt amounted to EUR13.734 billion, up EUR408 million compared to the year-end 2013. The level of EUR13.7 billion of debt also represents our best expectation at the year-end 2014 without any further M&A effects, thanks to the measures we planned for controlling the change in working capital in the last quarter.

Thank you very much for your attention. We are now pleased to answer any question you may have.

Questions and Answers

Operator [1]

(Operator Instructions). Alberto Gandolfi, UBS.

Alberto Gandolfi - UBS - Analyst [2]

Hi, good afternoon. It's Alberto Gandolfi from UBS. I have three questions on my side. Thanks for taking the time. The first one is a bit bigger picture on what's been happening between Russia-Ukraine. I know this morning they signed an agreement to provide gas, but we have seen some of the latest documents from the European Union talking about more emphasis on security of supply.

Now, your strategy of expanding and positioning yourself in Europe and being the key operator in Italy comes quite handy. So, on a -- it's a very long-term question, but on a five- to 10-year view on your best assessment, what would be the opportunities you can develop looking at these percentages of targets for interconnections within Europe, even though they're not binding, or what's going on behind the scenes? How can you drive the process to have more CapEx effectively?

A second question is, can you give us the latest in terms of when it comes to your discussions with the regulator in terms of the mark to market of the Italian sovereign yields,



besides what was written in the storage draft? Can you tell us where do we stand on the possibility of also marking to market inflation?

And under what -- and the third question is, under what circumstances -- so, if there's no inflation update, how would you think about your dividend policy? Thank you.

Carlo Malacarne, Snam SpA - CEO [3]

Thank you, Alberto. A comment for the crisis Russia-Ukraine. You know, it's positive that Russia and Ukraine will reach an agreement. In a way you -- we consider -- we have considered the possibility of maintaining the security of supply through the diversification of the sources we have in Italy.

In particular, up to now, neither the European nor the Italian gas market have suffered from any gas supply interruption from Ukraine. The stress test we carried out, not only in Italy, but at European level, the results are that, even in the harshest condition, the effect of the lack of supply could be managed. And so, I don't see a risk in this respect.

But, I think it's important evaluation, the medium- and long-term evaluation of the possibility of geopolitical crisis for the European supply. In this respect, we consider that our future control with the agreement with Fluxys of the corridor north-south and east-west give us the possibility to manage in the best condition the reduction of the supply risk, improving the flexibility and the interconnection to the different European countries, for south of Europe and Central Europe, but not only north-south, but the interconnection with the reverse [locatability] with the eastern countries today linked to the TAG pipeline.

I think it's not easy today to finalize or to, let me say, set in terms of investment the possibility of a new expansion. But, I think that with the existing network anyway, managing the trading facility, managing the flow at the unit level in the two corridor, we can resolve part of the -- let me say, the positive result of the interconnection to Europe.

In Europe, today anyway, we have an overcapacity of gas. And the possibility to match together the transmission system and the storage system give us the possibility in the medium-long terms to create the condition of the security of supply.

Our program, which are -- which we are discussing today gives the possibility to match the storage services with the transmission services, not only in Italy, but at European level. I think it's the only possibility to guarantee a security of supply during the winter period.



And in this case, in this respect, it's clear that the role of the TSO will be very -- not only very important, but will be -- give the possibility to the TSO to increase the capability of managing the network consequent to increase the possibility of new revenue with the new services at the same time to decrease the logistic cost in the transmission and storage system.

And you know, the logistic costs are the main aspect we have to manage and to decrease to give the possibility to the shipper to increase the trading system at European level. Only to say that I consider the crisis Russia-Ukraine not, let me say, without impact in the next winter period, but is a point of attention for all the governments in Europe, which give the possibility to increase the role of the TSO in terms of investment, services, and guarantee of the security of supply.

The second question was the regulatory.

Antonio Paccioretti, Snam SpA - CFO [4]

On the second question, Alberto, I think that -- I believe -- for sure, I believe that the transparency of our regulatory framework permits you to assess all the potential impact of the current macroeconomic scenario and therefore our revenues.

You know that, in valuation terms, the impact is not to be considered so relevant, given that our regulatory framework is designed to capture in the medium term the evolution of the financial scenario. What we have to manage are the impact in the short term. And on that -- in that aspect, what we can do is to maintain to -- what we can do for protecting our revenues, our margins, is to focus our financial strategy in order to maintain the most appropriate alignment between the [resulting of our] cost of debt and the frequency of the revision of the [fleet], so the duration on our debt.

Having said that, let me underline once again that the regulation -- our regulation is based on a return asset real, so net of inflation, which with the inflation that is impacting on the evaluation of the revaluation, the evolution of our [RAP].

On that aspect, it's important, again, to take into account the consolidation paper for storage, which confirm the attention that authority pays on the matter of the inflation and the correlation between treasury bonds and inflation, so confirms one again -- once again that the attitude seems to be to provide [for] condition for the settlement of the real term return.



Operator [5]

Pablo Cuadrado, HSBC.

Pablo Cuadrado, HSBC. [6]

Hi, good afternoon to everyone. Just three quick questions, please. The first one is on the TAG acquisition. Clearly, we need to wait and see the final reference of the preferential right issue. You mentioned during the presentation that there is going to be a credit from day one for Snam.

Was wondering whether you can give a little bit more color on the level of accretion. Are you talking or expecting to have a low single-digit EPS impact in terms of accretion or more mid-single-digit, just if you can more or less this more information about your expectations?

Second question is whether you can provide an update on how it's going on, the Italgas investigation, if you have any kind of new news on that front.

And the third one, I think, yesterday, the CEO of Enel made some comments on the Galsi project, basically [going] out or believing that potentially the project is going to be delayed again or even is not going to happen. I know, clearly, this is not included in the current CapEx plan, but whether you can share with us which is your views about the project, and if you're still seeing that is going to happen. Thank you.

Antonio Paccioretti, Snam SpA - CFO [7]

Pablo, few elements in order to give, as you said, some more color on target. I would start from the return we expect from the acquisition. It is clear that we need to wait for the closing. And it is for us necessary to understand the number of shares, to understand the impact on the purchase price allocation. And another important aspect is the restatement from the local accounting principle, which is -- which are today used by the Company, with the target company, and the IFRS.

Having said that, a few elements. First of all, in terms of return, also in this acquisition, we have used the threshold that we use [other times]. We have a target return on our investment which must be at least in the low double-digit level.



More important is the payback of the investment because, once we have considered in setting the price is that, in terms of cash recover, the cash payback, we expect to have the price to be paid recovered more than 90% recovered within 2023 -- so, 90%, sorry, 90%.

Therefore, what we have in mind is a return which is in line with our expectation and a payback which would permit us to recover an investment within the length of the current long ship-or-pay contracts.

The other important point is the earning per share, the impact. Again, it is difficult for us to give you a final number before having all the final results on the table in terms of number of shares, in terms of any adjustment in cash. But, what we can say is that the estimation made by the different brokers, which talk about 2%, 3% of accretion, are something that we consider reasonable.

Carlo Malacarne - Snam SpA - CEO [8]

Okay. Pablo, I give you an update of the Italgas situations. You know, the investigation is going -- is ongoing. And we've continued our cooperation with the Court of Palermo. But, the news is that, at the start of October, the Court of Palermo issued a further measure that set out the following, which is very important.

First, the absolute and temporary and short-term nature of the [preventive] measure, the perimeter of the judicial administration and state that no evidence has come to light that could prevent the consolidation Italgas on a going concern basis, both operationally and financially.

Furthermore, the measure confirm that Italgas must be run by the court-appointed administrators in accordance with the Snam strategic plan and budget and all the relevant Snam Group procedures.

As a result, we can continue to consolidate Italgas. And we made our (inaudible) of these. Therefore, the Group's consolidated cash flow will be unaffected by the investigation.

For the third question, Galsi, I said a lot of times that the investment decision of Galsi's was two years ago, not so easy, considering the gas demand evolution and considering the value and the total amount of investment.



And today, I think it's very critical to take an investment decision to start with Galsi. You know that we have not considered in our plan not only, let me say, the participation in Galsi, but we have not considered the investment to link the Galsi project to the national and regional network.

So, we wait. We await the final decision. But, I think that, today, we don't expect a final decision in the coming years will be taken by Galsi.

Operator [9]

Javier Suarez, Mediobanca.

Javier Suarez - Mediobanca - Analyst [10]

Hi, good afternoon. This is Javier at Mediobanca. I just have three questions on my side. The first one is on the cost of debt. The CFO has mentioned a target of 3.2%. Just a clarification of this 3.2% is by the end of 2014. And if so, which is the -- your expectation on the cost of debt by the end of 2015?

The second question is on -- related to the previous question on the possible effect that the TAP pipeline, Galsi, or new regasification plans may have on your business plan. Could you kindly update us on how do you see that these [farther] is strengthening of the European gas network through Italy may affect or not your business plan?

We have seen [Anagas] taking the decision to participate on the TAP project. We have seen yesterday (inaudible) looking or sounding quite critical with Galsi. And I guess that there is general interest for the opinion of regasification plans in Europe. How do you see the scenario? How do you see that this may affect your business plan in the next years to come?

And the third question is on Italgas. Can you clarify your -- if you intend or not to participate in the next gas auctions and the effect that this may have for Italgas? Many thanks.



Antonio Paccioretti - Snam SpA - CFO [11]

Yes, starting from the first question, the cost of debt, the 3.2% I mentioned before is the average cost of our debt for the full-year 2014. For next year, you know it is -- we are used to give the market guidance in the strategy presentation. Anyway, it is clear that we are confident to be in a position to give you a guidance at that time. So, I'm talking about March, but anyway in reduction -- cost of debt in reduction with respect to the one we will account in -- we will account for 2014.

Carlo Malacarne - Snam SpA - CEO [12]

For the second questions, first of all, I remind you that, in our business plan, for the investment, we consider today a new supply from south of Italy of 8 BCM. And you remember, I said that 8 BCM could come from TAP or new LNG. Today, I think there is a strong commitment by the government to speed the authorization of TAP. TAP is a diversification, a new diversification of the sources.

There is a strong commitment by the shareholder of TAP to bring gas by 2020. And we expect the final authorization to plan our investment. You know, our investment for TAP will be the Adriatic connection, the Adriatic Sea. This is the reason why, in our CapEx plan today, in the four-year CapEx plan, we don't have a spending for the Adriatic Sea, but it's beyond the CapEx plan to follow the deadline of TAP, which is 2019-2010.

In -- for the participation of some new shareholders, there is Anagas. There is Fluxys. Frankly speaking, there's no -- I usually I not comment the decision of the shareholder or the participation. But, I said a lot of time that we are focused on developing investment in the regulated business at European level to reinforce the capability of Italian network and reinforce the interconnection with Europe.

There is no -- we don't have today the -- completely the visibility of the evolution of shareholder structure of TAP. That is the reason why we -- in terms of a risk profile, we consider that is not in line with our risk profile, the risk profile of Snam today. But, the evolution could give us some possibility to evaluate in the future the participation. But, today, there is no, let me say -- the conditions to evaluate a new investment as a shareholder in TAP.

I remind you that the investment we are developing, the investment set in our CapEx plan, are namely the investment set not only in our CapEx plan and in the government CapEx



plan, but our investment set in the technical document of the European Committee. So, give us, let me say, a strong commitment in terms of strategic aspect of our investment.

It's a -- today, I -- is -- I agree that TAP will be very strategic new source of gas. But, we have to understand the evolution in terms of capability to bring the 8 BCM of gas, the evolution of the rules, the criteria set in the regulated business, not only in Italy, but in Greece and outside Italy, to understand the profile, the risk profile of TAP in line with our present conditions.

For Italgas, it's clear. We are -- I said a lot of times that we have monitored all the new ATM, the new geographical distribution area. And so, you -- we know very well today our possibility in bidding for the new area.

We are awaiting the municipality of the consortium of the municipality, have to prepare the bid for tender. We are monitoring the situation. And we will consider the possibility of bidding where we are sure to maintain the profitability we have today.

You know, the return in terms of EBIT to RAP is around 9%. Our intention is to bid, that means, increase the RAP in the condition, in a geographical area where we can provide the cost synergy and we can, let me say, transfer our capability to maintain low cost exercise of the network.

Javier Suarez - Mediobanca - Analyst [13]

Thank you.

Operator [14]

Maurice Choy, RBC.

Maurice Choy - RBC - Analyst [15]

Hi, good afternoon. Just three questions from me. The first two will be on international, and the third one will be on debt. The first question is about your formation of the JV with Fluxys. Can I just get an update on, firstly, obviously, the timing and whether or not you see any need for a cash exchange between the two parties?



The second question is about -- again on international. Could you just share with us I guess the vision of where this business is going? What share of earnings comes from international today? And how big do you think this can go by the end of the decade?

And the last question's more about the mix between fixed and floating debt. Obviously, currently, right now, and as of the nine months, you've got 70% fixed, 30% floating. So, maybe you could just share with us whether or not you think this is a optimal mix, or do you expect this to change a lot in the next 12 months? Thank you.

Carlo Malacarne - Snam SpA - CEO [16]

Thank you. The situation we are managing with the Fluxys, you know, after the signing of the MOU in end of March, Snam and Fluxys have agreed to assess and evaluate the setup of jointly control company for the integrated management of the respective assets across Europe, outside Belgium and Italian domestic market.

The joint company under consideration would combine Fluxys and Snam international assets located in the corridor south-north and east-west and would, in my opinion, play a key role as a facilitator of the creation of deeper market flexibility and liquidity through -- and enhanced interconnection of the European gas network and market fully in line with the goals of the third directive -- European directive.

We are working. We are in the due diligence process. We estimate to complete the agreement in the first month of 2015. So, I can give you some update with the strategic presentation in March. But, we are expecting the program we had one years ago in setting the new holding company.

Antonio Paccioletti - Snam SpA - CFO [17]

In relation to the other two questions, the first one is related to the contribution of our profits, margins, coming from abroad. I would limit the answer to the present year. In 2014, what we can expect is a contribution of an amount between EUR35 million to EUR40 million. I'm talking about the net income from associates coming from the interconnector and TIGF.

Starting from 2015, we expect also to consider together with this contribution the one coming from TAG.



In relation to the strategy, financial strategy, and in particular, the exposure to interest rates, to the interest rate evolution, from the beginning, from when we set the financial structure of the company in 2012 after the refinancing with the [NI], we mentioned a target structure of around 60%, 70% fixed rate, and [receivable] part of floating.

60% to 70% can differ in relation to the opportunistic [ways] and in relation to the timing approaching -- let me say that approaching the new [reset] of tariff that we expect starting from the beginning of 2016, it could be convenient for the Company to reduce our duration and therefore to increase a bit the floating rate position, so moving towards 60% instead of 70%.

Maurice Choy - RBC - Analyst [18]

Perfect. Thank you very much.

Operator [19]

Cosma Panzacchi, Bernstein.

Cosma Panzacchi - Bernstein - Analyst [20]

Well, good afternoon. And thank you for taking my call. I'm Cosma Panzacchi from Sanford Bernstein. I have a couple of questions. Like, the first one is on the international strategy. And the second one is mostly on distribution.

So, on the international strategy in particular, if we look again at the conclusions of the European Council, it appears to me that there's no precise target for gas interconnection and that the European Council has just repeated general objectives that were already there.

So, do you think that Europe will now allocate new resources for the development of cross-country gas infrastructures on top of the existing [PCI] program? And if yes, do you have any idea of when they will disclose it? Will it be part of the new plan of the [June cur] commission maybe?

And secondly, one of the things that we have seen holding back international infrastructure has been local oppositions by local communities. We have seen it, for example -- we are



seeing it now in [Puya] for TAP. We have seen it in [Abrutso] your own transportation business. So, I was wondering if you think that this could change in the future and why and if you think that, at regulatory level, there will be something to help out building this needed infrastructure.

On distribution, my questions would be, first of all, if you can update us on the status of the smart meters implementation in Italy and, in particular, if you are starting to see any operational benefits from the rollout.

And second, this week, we have seen the decision of the [TAG] tribunal in -- of Lombardi on some gas distributors, for example, [A2A and ATS], regarding the tariff of 2013. And I was wondering if this type of decision might actually positively affect Snam and, if yes, by which amount. Thank you, again.

Carlo Malacarne, Snam SpA - CEO [21]

Thank you. The comment for the international strategy, I -- first of all, you know, in the European directive was defined the rules of [Insog] in defining the total investment, strategic investment we need in Europe for the interconnection.

And today, at the technical body at Europe Committee, there are very clear. There are all the investment we need to guarantee the security of supply through the interconnection. I think it's under analysis by -- under evaluation by the technical body of the European Committee. I imagine that some more visibility of the strategic investment will be elaborated in the future.

Anyway, you know, we have the experience for TIGF in France. Fluxys have the experience in Germany. Anyway, all the company, the TSO today are, let me say, pushing by the regulator or by the government in some country to improve the investment interconnection.

For example, for TIGF, the regulator approved the business plan with the interconnection from south to north hub, let me say. It's a new investment in the business plan of TIGF.

We have another investment for improving the connection in Spain in the future business plan. But, it's not only the decision of the Company, but it's a commitment with strong as the return set by the regulator.

There is -- let me say the consequence could be that the investment will start before a clear decision by the European Committee because, in some country, some country need the development and the increase of interconnection capacity.



The same situation we have in Italy, we have some clients who are asking to increase the [reverse flow] capacity to Switzerland and Germany, which we are doing with Fluxys is to manage together the interconnection contract to -- let me say, to set with the authority of the countries, Italy and Germany, the best rules, the best criteria to facilitate the booking capacity by the shipper.

So, let me say, there is no [de libera] by European Committee, but there is a lot of business plan underway for the [new esbessa]. I can say that we don't need subsidies if the regulator will support the strategic investment.

And today, what I can say that, not only in Italy, but in France, for example, and in Germany is under discussion, the intention of the regulators is to support the strategic investment, not only, let me say, for the security of supply, but in some country, to create more competition in the prices, the case of France anyway.

In terms of authorization, you know, it's not the first time that we face the discussion with the local community. You bid in the last three years, four years 3,000 kilometers of pipeline in Italy is usually the discussion with the local community to reach the final authorization.

I think it's strategic the position of the TSO and the plan of the TSO. We have the possibility - - we started five years ago to discuss this point. I said before that the spending -- in terms of spending of the Adriatic Sea is no -- let me say, today, but we start in 2018. That is the reason why we have in front of us all the time to discuss some -- let me say, some tuning in the right way, some discussion.

I don't see, frankly speaking, the risk of stopping completely the investment. It's clear that we have anyway some backup. So, we can anyway bring the 8 BCM capacity if, in the worst case, if there's not the possibility to complete the Adriatic Sea, with other right of way. This is the reason why I don't see it could be a risk.

The second aspect is that, if the investment would be strategic, as TAP, I think that the news in the last two years is that there is more commitment by the Ministry of Development and the government to support in any case the investment. So, I think that it's clear that could be some local discussion. But, then if the investment would be strategic, there would be the approval directly by the government.

For the second question of smart metering, we are investing in the smart metering in Italgas following the program set and agreed with the regulators. By 2018, we have to complete



80% of the smart metering investment. In the CapEx plan of Italgas, we have in the next four years EUR350 million of the smart meter.

It's the consequence in term -- first of all, the smart meter today are investment with higher remuneration by the regulator. But, anyway, the advantages we can see in the new smart meter are in two -- there are two aspect we have to consider.

First of all, we will have a strong support for the decision in the dispatching gas in the transmission system. So, having not only the daily or weekly situation, but having the [hourly] situation of the gas consumption, we can create more synergy in the dispatching of gas to the compressor station to the dispatching center. And so, it is in terms of operating costs are synergy.

The second aspect is that, when the smart metering will be in place, in my opinion, we are working today in this contest. We can create and we can offer new services to our client in terms of cheaper or final residential -- for example, residential uses.

Today, there is not the distinction for regulated or nonregulated services. But, for the smart meter, we are the possibility to offer and create the new business plan of the new services that we don't have today, for example, the information for the geographical consumption, the local consumption.

That means that is a strong help for the shipper in programming and booking the daily capacity and is an impact in the economical impact for the shipper. In this case, we are working to create a set of new services to sell this type of services and, consequently, to maintain, let me say, our revenue and to increase our revenue in this respect.

Sorry, there's another question about the (inaudible) distribution, the decision for the tariff for the distribution. We -- the decision was clear. The [Tar Lombardia] is the court of -- the regional Court of Lombardia, the decision to partly repeal the deliverer, which set the tariff and the distribution last year in the determination of [VAC].

The decision of the Tar, the decision has accepted the filing of distribution industry, again, the deliverer. I think I have no specific comment. But, one I think is strategic. The Tar, the addition expression of the Tar is also contested the fact that the so-called Robin tax has not been appropriately taken into consideration in the determination of the remuneration rate.

I don't know the reaction of the authority, but anyway, it's an important point, will be an important point of discussion because it's the first time this will be a judge decision to -- let me say, to consider the Robin Hood tax in the different aspect in the distribution tariff in the



regulated business because we don't trust it directly to the final customer, the Robin Hood tax.

Cosma Panzacchi - Bernstein - Analyst [22]

Thank you.

Operator [22]

Stefano Gamberini, Equita SIM.

Stefano Gamberini - Equita SIM - Analyst [23]

Good afternoon, everybody. A few questions, if I may. First of all, regarding the [ERAP] change in taxation, what is the impact of a lower ERAP in your tax rate from 2015 onwards?

And second, regarding the RAP at the end of the year, if there are some changes in the RAP deflators, what is the RAP you expect at the end of the year?

Then I would like to understand a little bit more regarding this possible entrance on the shareholder structure of TAP. Is the TAP risk profile in line with your criteria? What I mean is, will you enter in the gas market selling gas to the wholesaler or final clients? I do not understand exactly how you can enter in the TAP shareholder structure without (inaudible) [gas] when this will be available.

And last thing, regarding AES Torino impact on the third quarter figures, what is the impact on EBIT? And if you can give us a little bit more flavor why the third quarter results were down compared slightly increase in the first and second quarter. Thanks.

Antonio Paccioretti - Snam SpA - CFO [24]

Starting from the first question, the tax rate of the Company and the expected one for the last -- for the next year, I would start saying that, for this year, we have to face the following evolution, Stefano.



We had a tax rate, a total tax rate last year of around 43%. For this year, we have to consider at least four elements which are contributing the -- our tax rate to be decreased to a level of 37%.

The first one is the Robin tax that [probably] know, which has a value of around 4%. The second one is the reduction of ERAP already decided that has a value of 0.5%. The same level, 0.5%, is the contribution of the application of [Achey], which has been possible according to the dividend policy we had entered -- dividends to be distributed from our operating company to the holding. And the last 1% is the reduction which is the result of a higher contribution to our net result before taxes due to the net income from associates.

Net income from associates this year will have a value which we expect to be without the nonrecurring item for us around EUR80 million, so EUR80 million plus around EUR50 million. And you know this is substantially new from a fiscal point of view. So, the 1% of further reduction is due to this higher contribution from net income from associates.

For next year, I would prefer not to give you numbers because we are not so sure that this proposal will be the only one having effect on our tax rate. Anyway, just for giving you the -- one number is that our labor cost is around EUR350 million. ERAP is 0.5%.

And so, it's this easy to understand, which could be the effect, the advantage only if the deductibility of cost of personnel from ERAP will be the only element. I think that it is necessary to wait for understanding better, which would be the aggregate effect.

For the RAP, the RAP evolution, I would as usual start from the RAP at the end of 2012, which is the one that has been approved for the tariff for 2014, which we consider in the range of EUR23.7 billion.

This is composed by EUR14.8 billion for the transport, EUR0.1 billion for LNG, and for the storage, we took about a level of EUR3.7 billion. For the distribution, we consider a level of EUR5.1 billion, which you know as -- is still to be finally approved. And it includes the -- includes around EUR300 million of increase coming from the positive effect of the new methodology applied for subsidies that has been decided in the last regulatory framework.

For 2013, we have used the [freight] of 0.5%. And on the basis of the investment we made and on this deflator, the RAP we estimate at the end of 2013 is EUR24 billion.

At the end of this year, we estimated a [fleet] of below 1%, assuming EUR1.3 billion of CapEx. The deflator, which is right below 1% and the RAP pertaining to Torino, which has



been consolidated starting from July, which is around EUR400 million, we are talking about a level of EUR24.8 billion.

If we consider the value of our affiliates, which today, for TIGF, Toscana, and Interconnector are something more than EUR1 billion, the asset -- the value of the asset is close to EUR26 billion, so with the leverage of around 50% to 53%, also at the end of this year.

The contribution of AES Torino to our EBIT expected at the end of the year is 20 -- around EUR20 million. This is for six months. And I don't remember the last question.

AES Torino, the contribution of EBIT and -- .

Stefano Gamberini - Equita SIM - Analyst [25]

-- And it was regarding the TAP risk profile.

Carlo Malacarne - Snam SpA - CEO [26]

The TAP is other question. The other question of TAP, to be very clear, there is no intention of Snam today to become shareholder of TAP. What I said is that we have -- you know, the joint agreement with Fluxys. Fluxys is a shareholder of TAP. Inside the holding, we are building with Fluxys one of the objective of the holder -- of the holding is to evaluate all the possibility of strength the interconnection with Europe in the regulated business risk.

Only if there will be this type of condition, we are ready to evaluate inside with Fluxys in the holding this type of possibility. But, there is no repeat intention today as Snam to become shareholder of TAP.

Antonio Paccioletti - Snam SpA - CFO [27]

There was actually the other curiosity, which is the result of the third quarter, which is lower than the previous quarters of the year. I think that the only item I just want to underline is on the [risk from] provisions that in the third quarter we accounted higher than the previous one.



Stefano Gamberini - Equita SIM – Analyst [28]

Okay. Many thanks.

Operator [29]

Monica Girardi, Barclays Capital.

Monica Girardi - Barclays Capital - Analyst [30]

Hello, good afternoon, everybody. I have a couple of questions. The first one goes back to the interim review for transport and distribution activities in 2016. I appreciate the fact that the authority in the second consultation document of Stogit was opening a door to a review of the inflation parameter as well.

In case the bleak case scenario happens, i.e. that the inflation parameter is not adjusted, I was wondering what's your flexibility into the CapEx that (inaudible) is peaking in 2016 and 2017, especially given that it's just interim review, it will be a temporary cut into the allowed return.

The second question is related to the guidance on -- of net debt for the full year. If I'm not wrong, Antonio, you said EUR13.7 billion. Just, I was curious to know if this target was or was not including the acquisition of TAG. And what is the level of working capital that you project for the full year? Thank you.

Antonio Paccioretti - Snam SpA - CFO [31]

The level of debt, the guidance of EUR13.7 billion is including AES Torino, which was EUR115 million, EUR110 million, does not include TAG, does not include TAG, neither for the payment of the stake which will be paid by shares, but also for the shareholder loans that will we have to -- for which we have to substitute the position of the sale.

The working capital, yes, sorry. As far as the working capital dynamics, in the first nine months, we had an absorption of around EUR250 million. We expect to put in place some measures in the four quarters in order to manage, let me say, the effect of the working capital evolution, maintaining more or less the same level on a full-year basis and therefore



permitting us to reach the EUR13.7 billion of guidance that was mentioned and that we were mentioning before.

The -- no, as far -- .

Carlo Malacarne - Snam SpA - CEO [32]

-- If I understood the first question, Monica, give me -- for the transport, distribution, I think it's positive that general approach by the regulator is to consider the market condition in the period.

And so, I don't think that could be jeopardized without consider -- jeopardize the economics of the financial without consider the market condition. Anyway, you know that the impact of the inflation or the deflator in case of investment, I don't think that could change our policy in terms of dividend.

Frankly speaking, I don't think that an impact could be so strong to, let me say, give us some advice of dividend reduction. Anyway, you know, in the CapEx plan, we have demonstrated in the last two years and three years, we have the flexibility to tuning the CapEx plan, take into account the cash flow production without stop or, let me say, delayed our project.

Monica Girardi - Barclays Capital - Analyst [33]

Thank you.

Operator [34]

Enrico Bartoli, MainFirst Bank.

Enrico Bartoli - MainFirst Bank – Analyst [35]

Hi, good afternoon. I have, first of all, a question going back to the European scenario and particularly on the connection between Spain and France. There has been, let's say, an acceleration recently in the discussions about this matter due to the Russian situation. It seems that the Spanish government is pushing for increasing the connection there. Could you give your feeling about the discussions on this matter and if you think that, reasonably,



in the short term, you could have investments for TIGF due to the expansion in capacity between these two countries?

Secondly, I would like to go back to this point about the inflation. Surely, you are discussing with the authority about the possibility to introduce the market value inflation for storage. Your discussions are also regarding the possibility to have an adjustment of the automatic update from transport, distribution in 2016, since -- considering to the current regulation only the [risk-free] rate is going to be updated. Thank you very much.

Carlo Malacarne - Snam SpA – CEO [36]

The first question, Enrico, is true, is under discussion the investment to improve the connection from Spain to France. In the business plan, I said before, of TIGF, there is some investment to improve the connection.

The deadline is, in the business plan, starting from 2018, not before only for one reason because the investment we are -- TIGF -- are developing today is to the bottleneck south of France to north of France. So, we have to complete the investment to the bottleneck, France region before, let me say, to bring more gas from Spain. This is the reason why, in the business plan, there are the investment starting from 2018.

We can -- I think there is the possibility to speed the investment. But, the deadline today is starting from 2018.

The second question, if I have understood clearly, it seems that, today, we cannot, let me say, what the regulator will decide end of 2015 about the inflation. It's not easy. What I can say is that, usually, the approach of the regulator independent of the number is to consider the financial and more the market condition at that time.

It's clear that the inflation setting procedure defined in the storage document is a good point to discuss with the regulator the possibility to expand the same approach -- to the same approach in the transmission and the distribution. But, clearly, we don't have today discussion in place about this point.

Operator [37]

This will conclude today question-and-answer session. I will now like to turn the call back to Mr. Carlo Malacarne for any additional or closing remarks.



Antonio Paccioretti - Snam SpA - CFO [38]

Okay. For there are no more question, thank you very much for attending the call. If you need any further information, please contact the IR Department. Thank you, everybody.

Operator [39]

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

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