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2019 Nine months results - Conference call

Thursday, November 14, 2019, 12:00



MODERATORS: ALESSANDRA PASINI, CHIEF FINANCIAL OFFICER

Operator: Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the Snam Nine Months 2019 Results Conference Call. As a reminder, all participants are in listen-only mode. After the presentation, there will be an opportunity to ask questions. Should anyone need assistance during the conference call, they may signal an operator by pressing "*" and "0" on their telephone.

At this time, I would like to turn the conference over to Ms. Alessandra Pasini, CFO of Snam. Please go ahead, madam.

Alessandra Pasini: Thank you. Ladies and gentlemen, good afternoon and welcome to Snam 2019 9 months results presentation. In the first quarter of the year we have continued to make good progress on our plan. Investments in our core business are in line with our full year budgets in a regulatory environment whole stability has been confirmed, by the final resolution on the 5th regulatory period for storage business.

The duration has been increased to 6 years and the data has been confirmed. Meanwhile, we have further consolidated our Italian footprint with the agreement to acquire 49% of Olt, a company which has been built and manages the offshore re-gasification terminal located circa 22 km off the Tuscan coast between Livorno and Pisa. Closing is expected in the first quarter of 2020.

We are improving our capacity to deliver new regulated services to the Italian market where we have earned €14 million plus 40% compared to the same period of last year. We have continued to cut cost achieving in the first 9 months of the year €45 million of cumulated savings since the program was launched.



Our focus on the energy transition remains strong. On sustainable mobility, we have already reached our full year budget with 74 third party CNG and LCNG stations contractualized. Meanwhile the long term potential of green and low-carbon gas has been confirmed by the joint scenarios published by Snam and Terna.

Regarding our international sources, TAP is progressing well, it is circa 90% completed and we confirm the COD at the end of 2020. The progress on the interconnection between TAP and the Italian grid is also progressing and it's circa 25% completed. The 01st of October Teréga has announced that bondholder has consented to modify the total net leverage ratio of the company creating the opportunity to optimize the capital structure. On Snam capital structure in September we launched a 500...5 years zero coupon notes and a €600 million 15 year note at 1% essentially pre-funding Snam 2020 maturity.

Looking more closely at the results, in the first 9 months of the year, regulated revenues grew by 3.3% driven by WACC increase, the growth in the asset base and the increase in output based incentives. EBITDA was up 4.1% as a result of higher revenues and further effect of circa €9 million related to our efficiency program which had been launched in 2016. A portion of this increase circa €10 million will be reabsorbed by year end, it is mainly due to higher gas injected in the first 9 months of the year when Italian gas demand lowered by 5% and the postponement of some cost to the last quarter.

Please consider that in 2019 the new businesses are still affected by integration cost and the launch of new initiatives, so they are not providing a contribution to the EBITDA. Net income from associates was up 29.8% mainly thanks to the contribution of DESFA and Teréga which will be commented later on. Net income is up 9.3% also benefiting from lower financial charges leveraging on continued favorable market condition.



EBIT in the first 9 months of the year was €1.125 billion up €35 million over the same period of the prior year. This number reflects the increase in regulated revenues of €59 million mainly due to the increase in the allowed remuneration, tariff RAB increase and a gradual ramp up in regulated services for €4 million. The effect of the cost cutting plan that has delivered further €9 million in 9 months 2019 and is expected to generate circa €60 million saving by year end compared to 2016.

Regarding the cost cutting activities, let me underline some example of this benefit. The insourcing of specific maintenance activities for €1 million, the automation of some IT processes that will deliver €2 million and the replacement of obsolete IT devices with ones that are more efficient and have lower maintenance cost for €0.5 million.

Other components gradually offset each other, they include negative, such as the higher costs for new initiatives and related integration, M&A cost and the release of a provision in 2018 and higher variable cost mainly related to energy cost. And positives such as lower early retirements, higher sales of materials, the adjustment for IFRS 16 and lower capital losses.

Net profit for the period was up €74 million compared to last year, on top of EBIT growth this was driven by lower interest expenses of €25 million. Thanks to last year liability management exercise, funds were lower and treasury optimization carried out during the first 9 months. This was partially offset by the absence versus 9 months 2018 of the income from TAP shareholders loan in fact TAP has completed its' non-recourse financing at the end of 2018.

The positive performance of our resources driven by the trends we highlighted already in first half. These are...the acquisition of DESFA completed at the 2018. Its performance in the first nine months of 2019 has been driven by the surge of gas demand increase. DESFA contribution in



full 2019 is expected to be more than twice as much as acquisition budget and is expected to normalize going forward.

The higher results of Teréga, mainly driven by the increase in asset base, lower depreciation related to the acquisition premium and the positive one-off effect connected to the release of a tax provision accrued in 2017 of €6 million which will be partially absorbed by €2 million one-off charge related to the payment of the constant fee to Teréga bondholders. Taxes were higher due to an earnings before-tax. The tax rate for the period was 25.8 on EBIT including associates versus 26.3 in the first nine months 2019.

The lower tax rate is mainly due to the increase of the share of net income arising from the contribution of the sources. On a full year basis, the previously indicated tax range of 26% to 27%, we now expect to be towards the lower end of the range.

Turning now to the dynamics driving our cash flow; cash flow from operations for the period amounted to circa €1.2 billion, considering €146 million of negative income from working capital movements. Of this, €180 million negative related to the payment in favor of capital CSEA [indiscernible] in order to regularize the overcharges and penalties cashed in, in the last years, minus €85 million in tariff related items of which 42 additional target components and €43 million due to overcharging and penalties. And a positive contribution of €157 million related to taxes that will be paid in November.

The operating cash flow covered net investment and equity cash flow, mainly including the payment of the interim and final dividend of €746 million, leading to a net debt at...for the nine months at €11.9 billion. For the full year, working capital is expected to be essentially in line with guidance.

And now, let me give you an update on our debt structure. In the first nine months, DCM and EIB funding amounted to approximately €1 billion with an



average maturity of 9 years and average yield of approximately 1.3%. This replaced €770 million bond at an average cost of circa 3.8 expired in the first half '19. Thanks to the actions completed so far, we've been able to achieve a significant reduction in terms of cost of debt versus the same period of last year of 30 basis points.

Moreover, in September, we completed a significant funding exercise for €1.1 billion of which 500...at 0 to 5 years, the 3rd [ph] year coupon issued by Snam the Italian corporate to achieve this target, and €600 million bond with a maturity of circa 15 years, the longest tenure ever issued by Snam so far. Thanks to this exercise, we have already almost addressed the funding need for 2020, whilst locking in today's very favorable market conditions.

On the banking side, we realize that we have achieved the target in business with our €3.2 billion sustainable loan. We are getting a discount to 2.5 basis points in the facility margin starting from April 2019. We have extended the maturity of the €3.9 billion loans out to which the €3.2 billion [indiscernible] by one year up to July 2023 and December 2024, for €2 billion and €1.1 billion respectively. And €700 million bilateral term loan by 1.5 year at negative costs. In the remaining part of the year, we will be focused on the following...continuous focus on treasury management optimization and optimization of our financial structure, including our sources.

Thanks to the actions completed so far, and the continuous focus on utilization we can confirm the guidance in terms of net financial charges we've been able to provide in July.

Thank you for your attention, and we will now be pleased to answer any questions you may have.

Q&A



Operator: Excuse me. This is the Chorus Call conference operator. We will now begin the question and answer session. Anyone who wishes to ask a question, may press "*" and "1" on their telephone, to remove yourself from the question queue, please press "*" and "2." Please pick up the receiver while asking questions. Anyone who has a question, may press "*" and "1" at this time. We will pause for a moment...as callers join the queue.

The first question is from Javier Suarez from MedioBanca. Please go ahead.

Javier Suarez: Hi, good morning, and thank you for taking my questions, I have 3. The first one is on the numbers, on Slide #6, and on the net working capital evolution. There is a negative impact of €146 million. You can share with us where that number should be by the year end? That is on the cash flow statement. And also on Slide #4, you are showing on the evolution of controllable fixed cost €6 million contribution from the ongoing efficiency program, where that number should be by the year? That is the first question.

The second question is on the regulatory development. There is the regulator has probably the final ruling on gas storage, as part of the confirmation of the work at 6.7% in the periods '19-'21, if you can share with us other information from that final ruling on gas storage that you think is important to highlight? And also you have any...you want to share with us any...your reading of the last consultation document on re-gasification...for the re-gasification activity.

And then the third and final question is on the acquisition of Olt that you announced by the end of September, you can share with us the rationale for this acquisition and also the multiples that you...that you are paying for 2019? Many thanks.

Alessandra Pasini: Thank you, Javier. So on the first question on numbers, on working capital we essentially confirm what we indicated in the past. So we indicated our



year end guidance of net debt was factoring circa €100 million negative FX from working capital that's still the number we have in mind, so let's confirm.

On the efficiency program, we will...we are targeting at circa €50 million, sorry, of overall efficiencies of our cost-cutting plans since the beginning of the start. So that's the number that I confirm.

When it comes to regulation on storage, I think that, you're right, I mean, WACC of course is, and the detail where one of the factor, I think it's important to remind that the length of the regulatory period has been extended to 6 year which gives a lot of visibility and that's clearly positive. The calculation of the tariff RAB has been confirmed in terms of methodology. Again, dismantling cost continued to be recognized and the OPEX 2020 calculated on the basis of related variable 35 [ph] years of 2019 has been confirmed, and will be updated through the usual price cap mechanism.

And I think the other important point is that the guaranteed factor is strengthened to 100%. So all-in-all everything gives, if anything more visibility to the storage business than it was before. When it comes to the other ongoing consultation, I don't think we have nothing specific to say. It's not that the consultation is progressing well. We've been having...we are in constant dialogue with the regulators on this topic, but we are in the middle of it.

When it comes to Olt, I think the acquisition is important because we all...we have access and exposure to all of the 3 infrastructure, which brings LNG to Italy. In the case of Olt clearly is regulated differently from LNG, which instead is an exempted asset and therefore not regulated. It is also important because it focuses on the possible contribution that LNG terminal can give on small scale LNG development. And so of course, we are working on it already on our existing terminal. But that's something that also characterized Olt going forward and so this is equally important.



I think as you saw, we paid exactly the same price that the other future partner paid would...I think multiple is, probably not the right way of characterizing these acquisitions. But is it a multiple, which is accretive to us because it's a significant discount to where we trade at. But also it's fair that we all know the regulation in the case of LNG as a guaranteed factor. So I think we are...we paid an adequate price, we think for the assets, which has strategic...give us a strategic opportunity to cover the entire market in terms of existing infrastructure and LNG.

Javier Suarez: Thank you.

Operator: The next question is from Enrico Bartoli of MainFirst. Please go ahead.

Enrico Bartoli: Hi, good morning. Thanks for taking my question. The first one is relating to operating cost, if I right, in the third quarter actually they went down significantly to last year, even considering the negative one-off that you have in the third quarter. So I was wondering if there were some seasonal effects or special effects there, and if this trend can be extrapolated also for the fourth quarter?

The second question is related to associates. There had been a continuing growth in the contribution for associates in the 3 quarter this year. It is reasonable to assume that this trend will continue also in the fourth quarter considering also the reconsolidation on DESFA.

The third one is regarding guidance. Considering the nine months growth in EPS, which is almost double-digit. The guidance obviously is 7% increase for the full year is still reasonable, and in case can you elaborate a bit why we should expect a slowdown in the growth in the fourth quarter? And the last one is, if it is possible to have the breakdown of EBITDA in the 9 months between transport, storage and other activities. Thank you.



Alessandra Pasini: Thanks. On operating cost, there is some phasing element that needs to be considered. So the nine months have benefits from lower cost because some activities were postponed to the last quarter let's say a rough €10 million number is cost that we will see coming up in the fourth quarter which still as usual will be lighter in terms of overall contribution versus the full year. I think we on average we are between 20% and 22% contribution in the fourth quarter in general in terms of rising rate.

When it comes to associates, I think that overall you should assume some sort of...particularly I am talking DESFA normalization, i.e. the last quarter again will be lighter versus the first 3. In particular, there will be some tariff related items. So 2 things we are remembering on DESFA for the last quarter, 1) some tariff related items, and 2), as you will have seen we have signed an agreement for the sale as all of the...not just Snam but also Senfluga, so the holding company that controls DESFA, the sale of 10% or stake to Greek investor [indiscernible]. We expect this to be completed by yearend, and that of course will reduce proportionally the contribution of DESFA. So I think that should help in not assuming additional one-off actually normalization of some of the strong performance we have had in the first nine months particularly as I said around DESFA.

When it comes to guidance, we are not here to say anything different from what we said in July so we confirm the 67% guidance in terms of growth that we gave you in July. And in terms of breakdown in terms of transport and storage, I think in the annexes you do have some breakdown that is what we usually provide for key assets and regulated and non-regulated cost, which I think is consistent with the disclosure we always gave.

Operator: Then next question is from Harry Wyburd of Merrill Lynch. Please go ahead.

Harry Wyburd: Hi, everyone. And 3 questions from me, please. So, firstly on, like you mentioned there was an opportunity to optimize capital structure there. So I see that means an opportunity to extract some cash from the business by



increasing the leverage there. So have I understood that correctly and what could be the quantum of cash that you potentially released from that? And then on Olt, just...I don't know, if you have mentioned this before, but could you just give us a guide, so that the overall level of net income or EPS accretion you expect from that deal, because if I understand correctly you obviously book associate income on your stake, but you will also book interest income on shareholder loans to the business. So if you could just give us...help us understand what the income statement lines are, are they going to be effective by that deal and then the overall level of accretion we should see more on annualized basis. Thank you.

Alessandra Pasini: Thank you. So on capital structure, I think I meant 2 things, 1) when it comes to Teréga. We have carried out a consent exercise, which means that we may optimize Teréga, capital structure together with the other shareholder, but this is not something you should expect this year.

When it comes to our capital structure organization, what we mean is everything we can do to benefit from the current positive market conditions is something that we will consider doing on our existing debt. So effectively optimizing tenure and cost for Snam, similarly what we have been doing over the past several years. So, this is not necessarily extraction in cash, but optimizing our debt structuring cost.

So when it comes to Olt, I think that we will, of course, have better sense of actual numbers when we come in the course of 2020, and is also a function of when we will be coming out...coming in into the company. I think you need to remember that the structure envisages a shareholder loan that is remunerated, and so the contribution that this will give to Snam will be effectively given by 2 components, on one side the remuneration of the shareholder loans and on the other side the contribution to net income.

So I don't want to go into details that are not public at this stage as this transaction is not yet closed. But, the overall return of this asset is consistent



with what we yield on our regulated Italian asset basis. And the contribution that we will see going forward, the combination of these 2 elements where and effectively the shareholder loan components weighs slightly more or more than what we expect to make in terms of net income contribution.

As you can imagine this is subjected to some city, and I don't think it would be appropriate for us to get into a more disclosure vis-à-vis the actual number...numerical contribution that Old would give...but hopefully this helps you making a little bit. If you look at the old numbers from here and you can make your own assessment of what the equivalent contribution will be for us going forward.

Harry Wyburd: Okay. Many thanks.

Operator: The next question is from Emanule Oggioni of Banca Akros. Please go ahead.

Emanule Oggioni: Thank you. And good afternoon everyone. I have 2 questions left, one is on Olt, but in term of...I wonder if you could share with us the potential synergies, you can extract from the company? And the second one...the second question is on Teréga. If there any update on the impact based on the latest consultation document on your figures? Thank you.

Alessandra Pasini: Thank you. As it relates to Olt, we will step into an existing facility which has a number of constructional arrangements for the O&M of the company. Operational synergies is something that may come more later on rather than immediately, but that's, of course, something that we will be working on. I think what is really important for us is more the commercial synergies, the fact that we will have a platform with the presence in all the 3 terminals operating in Italy in a time where cargos number is increasing and that will allow us to optimize our strategy and effectiveness on small scale LNG presence.



When it comes to Teréga, as you know there is an ongoing consultation document, which has provided a possible range of WACC for transport between 3.6 and 4.4 with the delta proposed of 50 bps of storage essentially what is the vision look at is normalizing the cost of debt for lower risk free rate which we have seen in the market and factoring a tax decree which has been proposed, which envisages a lower cost of tax rate in France.

As you can imagine, we are in the middle of the consultation with the regulation we don't guide on what we expect, but the factually you can make the math, if we end up in that range what could be the implication for us. We are positive the dialog will be regulatory is constructive, and there are number of other items that are being discussed. And so despite the perception that WACC reduction will have an impact we are still working with the company and our partners to try and offset part of this which reflects different macro environment in our numbers that we expect the consultation to be still ongoing, and the final decision to come by year end. So it's not the right time for us to provide specific...and more specific comment on this.

Emanule Oggioni: Thank you clear.

Operator: Ms. Pasini, there are no more questions registered at this time. I will hand the floor back to you for your closing remarks.

Alessandra Pasini: Thank you very much for everyone for your time and attention.