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2020 Nine Months Financial Results Conference Call

Thursday, November 05, 2020, 14:00 ITA Time



MODERATORS: ALESSANDRA PASINI, CHIEF FINANCIAL OFFICER

OPERATOR: Good afternoon. This is the Chorus Call conference operator. Welcome and thank you for joining the SNAM 2020 Nine Months Financial Results Conference Call. As a reminder, all participants are in a 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's 2020 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 above previous year level, and we are fully recovering the delays due to COVID. We confirm €1.1 billion of CAPEX on a full year basis, assuming no COVID-related stoppage of the operating activities.

We continue to deliver on new regulated services to the Italian market, where we have earned €15 million, €1 million more than 2019, also considering the regulator is raising the bar with more challenging KPIs. We are continuing on our efficiency plan, already achieving in the first 9 months, €60 million of cumulative savings since the program started in 2016, which was our annual target. Our focus on the energy transition remains strong. In addition to the progress already announced on biomethane and its energy efficiency, we've also made progress on our hydrogen strategy.



We've recently signed a partnership agreement with ITM Power plc, one of the major global manufacturer of PEM electrolyzer, aiming at establishing a commercial and technological collaboration and gaining expertise on the market evolution of technology. We also signed a memorandum understanding with Ferrovie dello Stato to promote the use of hydrogen in the railway transport. Please consider that 20% of the national system still runs on diesel.

On the international front, started works to allow the connection with the Southern corridor have been completed. On the debt management side, financial charges were €26 million lower than the same period of last year, thanks to the market supportive environment. In September, Snam has launched together with the United Nation Global Compact CFO taskforce, the CFO principles, our integrated SDG investments and finance.

These initiatives has the goal to bring together the investment value chain, including issuers, investors, banks, development finance institutions, credit rating agencies and sustainability assessment firms to create an efficient market for SDG investments and instruments and capital flows and consistently now to measure ESG KPIs and actions.

On the 27th of October, the rating agency S&P has affirmed the company long-term corporate credit rating at BBB+ and revised the outlook from negative to stable. The decision reflects similar action taken on the outlook of Italian government sovereign rating.

During the first 9 months, gas demand closed with 49.8 bcm with a decrease of 4.6% versus 54.4 bcm of last year, combining the effect of mild weather conditions and COVID. The decrease is largely related to the civil sector, mainly due to the milder weather conditions and marginally for the gradual increase due to energy efficiency measures.



The industrial sector lost almost 1 bcm, mainly due to the COVID lockdown effects and the thermoelectric sector reduced mainly due to the drop in electricity demand, again related to the economic slowdown. [Indiscernible] of the restrictive measures, gas demand has shown improvement versus the same period of last year, leading to an increased forecast of 70 bcm at year-end from what we previously announced in July. The recently announced restricted measures may have some impact. Despite the rise of gas prices, mainly in August and September, switching coal-to-gas remains convenient and compared electricity [ph] production stays at minimum levels.

Looking more closely at the results. In the first 9 months of the year, regulated revenues grew by 1.6%, thanks to the IRAP [indiscernible] D&A and the contribution from output-based incentives including energy cost for €52 million. As you may recall, from this year, energy costs, which were previously addressed in kind, contribute to revenues and costs, but with essentially no impact on EBITDA.

On the opposite side, the commodity component of our revenue that is related to volumes declined compared to the same period of last year, and we will comment in more detail in the next slide. EBITDA was up 0.5%, also thanks to the effect of the efficiency program and the initial contribution of new businesses despite a slowdown due to COVID. Financial charges were down 21%, thanks to the continuing treasury optimization measures and the natural bond rollover. As a result of all the above, net income is up 0.7%.

Our full year guidance for net income remains at €1.1 billion, on the same perimeter, thanks to the solidity of our core business, the growing contribution of new activities in the energy condition, cost containment actions implemented and treasury optimization measures.

Adjusted EBITDA in the first 9 months was €1.670 billion, up €9 million compared to the same period of last year. As explained, during our interim results presentation in July, from this year, the recognition of energy costs,



which we're addressing until last year is included in the regulated revenues and cost line, but remains essentially neutral EBITDA level. Before in this slide, we have represented regulated revenues and other core items net of energy cost.

The decrease of regulated revenue is due to a decrease of the commodity component of our revenues year-on-year by around €30 million, due to the COVID effects that impacted gas volume in the first 9 months compared to strong volumes booked last year, a different revenue recognition for the commodity component recording it on a progressive basis at year-end, on a full year basis, and the effect will be minus €18 million versus last year. As we said many times, the plus or minus €9 million is the maximum impact from volumes on our revenues.

We also had higher tariff slabs and a lower [ph] D&A and a reduction of input-based incentives compensated by a slight decrease, as I said before, of output-based incentives. The increase in cost, fixed cost item at €3 million was due to a series of effect, including lower cost capitalization for €4 million related to the lockdown, difference versus the relief in the first 9 months of last year of a preretirement provision of €6 million, all the above, largely offset by €7 million of savings related to COVID.

The item "other" is made up by a number of assets, the effect of the regulatory recognition of energy costs that were negative by €12 million in the same period of last year and partially neutralized in the last quarter of last year, lower provision and capital losses for €8 million and the positive contribution from new businesses for €5 million despite the COVID delay. We expect our new businesses to continue to gain momentum in the last part of the year, save for limitation of working [indiscernible].

Net profit for the period was €873 million, up €6 million versus the same period of last year. This was driven by the operating performance that I just commented, lower net interest expenses for €26 million, and the decrease



year-on-year of the contribution from associates, mainly due on Teréga, the absence of the positive one-off effect accounted last year and connected to the release of a tax provision accrued in 2017, the kick-in of the new regulatory period and a lower short term revenue at stain [ph] exit point versus last year.

The normalization of the performance of IUK after 2019 that was characterized, as we commented before, by an extremely strong capacity booking, and that impacted for €7 million. And the initial contribution of ADNOC consolidated from July and from TAG, all of the above account for approximately €10 million. With reference to TAG, the contribution is mainly due to tariff accounting adjustments. Lower taxes are mainly due to the reintroduction of ACE benefit, which were not present last year.

Turning now to the cash flow. Cash flow from operations for the period amounted to circa €1.3 billion, including €16 million of working capital absorption. Of this, €56 million of undercharges due to [indiscernible] as a net effect of 2 components, minus €109 million undercharges mature in 2020 that will be recovered next year. And such effect may marginally increase by year-end and plus €53 million of undercharges related to 2019 recovered this past July.

The contribution of €35 million of additional items as we have fully been able to recover the billing process delay experienced in the first half, such delays were a consequence of a process change at the Italian energy system operator [indiscernible]. Cash flow from operations cover CAPEX and CAPEX table and financial investment outflows for the completion of the distribution and OLT and ADNOC.

Other outflows of the period has been the dividend payments and buyback for €114 million. This led to a net debt at the end of the 9 months of €12.8 billion. On a full year basis, net debt is forecasted to remain at €12.8 billion,



including also the recent energy transition acquisition in ADNOC and the negative tariff working capital effect of €0.1 billion as per prior guidance

Moving briefly to our debt structure. We can rely on ample liquidity of approximately €3.2 billion of RCF, coupled with significant undrawn committed facility. As regard to that breakdown at the end of the third quarter, the fixed-rate portion was 71%, in line with our prior guidance, which we confirm. Maturity of medium to long-term debt is circa 5.3 years, with a maturity profile, well spread over time and a strong liquidity profile.

On sustainable finance, Snam is continuously improving its financing instruments to be more aligned with the corporate strategy. And at the end of September, circa 40% of our total committed lines are in sustainable-related instruments. Fund raising at negative yields remains a key source for treasury management optimization.

The optimization has been possible, also leveraging on the full utilization of the Euro Commercial Paper Program with an outstanding amount of €2 billion and the supportive market environment for uncommitted credit lines. We have recently renewed our Commercial Paper Programs for a total maximum amount of €2.5 billion with potential ESG content.

We will now be pleased to take 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.



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

JAVIER SUAREZ: Hi, good afternoon. Thank you for the presentation, 3 questions from...on my side. The first one is on the regulatory update. If you can update us on any discussion or conversation with the regulator on the possible introduction to a recognition for fully depreciated asset. And also, if you expect that in the regulatory discussion of next year the theme of renewable gases should be part of that regulated discussion, and therefore, should be part of the regulatory framework from 2022? That is the first question.

And the second question is on hydrogen. If you can help us to understand the recent deal that we have signed with U.K. producer of electrolyzer and...which is how Snam does its role within the hydrogen value chain, if you intend to concentrate on reinforcing the pipeline or your investment can also include the electrolyzer. And if that is the case, if the electrolyzer is going to be part of the regulatory asset base.

And the third question, I guess, is related to the previous one, it's on your M&A activity. If you are going to concentrate potential additional M&A on the hydrogen theme trying to bring into the company new capabilities related to the hydrogen opportunity. And if so, which are those additional know-how that the company feel that should be added through additional M&A? Again, thanks.

ALESSANDRA PASINI: Thank you, Javier. On the regulatory update, we continue to progress on our dialogue with the regulator, you will be, of course, getting an update on our plan in a couple of weeks' time. I have no specific indication to share at this point in time, only that the discussion is progressing as we expected and that we are on the regulators...fully on board with the need of sharing the path towards replacements and a program that address this with...this opportunity for us.



When it comes to the green gases, it's a very fair point. I think that first, we will need to see what our country in terms of energy policy will...position will be around hydrogen. We understand that there are a number of reflections going on from an institutional standpoint and a vision is being formed. And with that vision, of course, that will stand the type of ambition and targets that Italy may have similar to what other countries have already done, I mean. Germany, France, Spain and others have come out with their hydrogen plant. So that will be the first step.

I think that subsequent to that, the discussion with the regulator that has already started around the crucial role of green gases that will get into a more concrete phase, if you want. But I think what is important, at least for us is that in those countries where an hydrogen policies already come out and even at new levels, if you read hydrogen policies, there is a very clear statement around the centrality and the strategic role that existing gas infrastructure will have to achieve those targets, which I think is a very good place from which we will be starting our discussion at the right time.

When it comes to ITM, I think it's...the way we view that is, it's really effective way to enhance our understanding of the technology, and therefore the...at the forefront, where the technology is going to go. The agreement envisage a very small equity contribution. But there is a program of the government [ph] of non-employees by ITM. And there are committees that will look at the product development and also if you want, strategic and business development of the company.

And so I'm not sure you should view this as an M&A. I think it's...as we've been doing in other elements in our areas of the energy transition, it's like in-sourcing competencies in a way and making sure that we have a full understanding of the speed, the pace and the complexity of how hydrogen value chain will evolve and develop in a way which will be synergic and conducive to our existing infrastructure presence.



So you ask is it going to be RAB-based early stage [ph], I think there are countries that are more ahead than us in this debate. I've been starting to discuss this. I think we will have that discussion at the right time. For the time being, I think what is important for us is really understanding the competitive nature of hydrogen in the energy mix and the role that we can play into it and then [indiscernible] are key components of that equation.

And so this leads me to the third question, which I have in part addressed, we will continue to look for competencies and know-how. That is a comment that I'm making around the energy transition platform as a whole, not just hydrogen because this is something that is going to be very relevant to really understand also how our infrastructure can be more valuable in the future.

JAVIER SUAREZ: It's very clear. Thank you.

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

ENRICO BARTOLI: Hi, good afternoon. Thanks for taking my questions. I'd like to connect to the previous question regarding M&A. You had some transaction in the biomethane business. If you can please elaborate a bit actually your strategy there and how much would be the opportunities for Snam to develop this business. What is the target, the strategic target if you want to become a national player or exploiting some opportunities in synergy with your current operations? And always linked to the, let's say, the new businesses, if I write it in the 9 months, actually, they started to contribute to EBITDA by €5 million. If you can provide guidance of what you expect for the full year and possibly some possible evolution for 2021?

And the last one is regarding the cost of debt. You have been reducing very significantly your cost of debt in the past quarters. If you can elaborate a bit on the additional room that you think that you could have of further reducing your cost of debt, considering the current situation in the credit market and the possible outlook?



ALESSANDRA PASINI: Thank you. On...yes, we've been doing and closing a few things that have been announced before on biomethane and energy efficiency. I think we gave the vision, and you will hear an update and a much more granular update on our ambition and strategy at the...at our strategic strategy day on the 26th of November. So the 1 to 3 [ph] run, any of that. But conceptually, we see a lot of room for what is a nascent and fragmented market on the biomethane space.

We're very pleased with what we've been able to achieve, but we would continue to grow. And this is not even an M&A, frankly, because what we are doing is really in-sourcing existing or nascent or prospective projects and then it's like CAPEX. And so the way to look at biomethane, I'm not sure if we look at that as an M&A, but it's more a CAPEX-related platform growth type of opportunity.

When it comes on energy efficiency, we've been in-sourcing competencies to create a platform, a platform that can operate in the residential space. It can operate in the industrial space and can operate in the public sector space. This platform once it has all the competencies on board will pursue organic growth with, again, the ambition to become a national player. Of course, in the energy efficiency space, which is one of the areas where Italy is lagging a little bit behind certain countries, the opportunities are very significant. And the energy efficiency and the energy consumption in...from buildings and offices is one of the main causes of CO2.

So again, this is very much central to our ESG vision, but also to the policies that the government has been launching and promoting and addressing this issue, and making sure that Italy evolves also on this front and is more aligned with what the France or Germany or U.K. has already been making. So the ambition is to continue to grow. You will be hearing more on our plan.



I don't want to give now any guidance for '21, as it wouldn't be appropriate. But please bear in mind that we're talking about things that is already generating EBITDA. But in many cases, they will be simply CAPEX development for new plants that will come into operation in due course.

When it comes to the cost of debt, clearly, we're taking the benefit of the current market environment, and we will continue to do so as long as the market environment allows us to do so. You will see at our plan. If you take today the forward curve that's where our cost of debt over the plan horizon is going to come lower than last year, simply by virtually looking at the forward curve. And we will remain opportunistic in that regards because this is a unique opportunity to set the cost of debt of this company at the lowest possible level. But we are talking about marginal improvement given the level that we have already reached.

ENRICO BARTOLI: Thank you.

OPERATOR: The next question is from José Ruiz of Barclays. Please go ahead.

JOSÉ RUIZ: Yes, good afternoon. I have just 2 questions. The first one, if you could guide us, what are your estimates for gas demand in Italy for 2020? And secondly, we had the Minister of Development, mentioning a minimum figure for the hydrogen plants in Italy at €3 billion which is good, that is a minimum. But actually, the number is too small compared to other hydrogen plants we have seen around Europe. Can you please clarify what did you understand by this €3 billion, the starting point?

ALESSANDRA PASINI: Yes. On gas demand, as I said, we currently see 70 bcm, roughly speaking, between 70...69 and 70 bcm on 2020. Therefore, 3 bcm more and better than what we expected when we last spoke in July. However, this does not reflect the fact that the current or the new levers...newly introduced or recent or to be introduced measures may have an implication in terms of slowdown in the economy. So depending on how that unfolds,



this number may actually be potentially revised a bit downward. It's also a function how winter will be in terms of weather. So far, the fall has been mild. So to be specific, 70 bcm is the estimate we have now. But we need to see how the COVID implication will continue to impact from a GDP standpoint.

On the second question, I think that was a comment. I mean, as I said before, we know our institutions are working on their vision. And so that is really to be seen as a first indication, not something that is set as a policy or a target or something like that. We will clearly...we're providing our perspective in that context. And we hope to have some update maybe by the time that we come out with the strategic plan. But I wouldn't speak too much on that individual number, what we expect is more of a vision and a more comprehensive perspective to come out at some point from our institutions.

JOSÉ RUIZ: Thank you. Very clear.

OPERATOR: The next question is from Stefano Gamberini of Equita. Please go ahead.

STEFANO GAMBERINI: Good afternoon. Two quick questions, if I may. The first regarding CAPEX, you set this target of €1.1 billion CAPEX in 2020. Do you see some risk due to the COVID situation? Or do you see some risk of lower trend in 2021 due to this situation is [indiscernible] 2021 should accelerate CAPEX versus 2020? And the second, regarding net debt, if you can repeat what is the target of net debt at year-end and the impact of working capital. Many thanks.

ALESSANDRA PASINI: Thank you, Stefano. On CAPEX, our €1.1 billion are, I think, relatively safe. We've been literally running and adding...making a gigantic effort to close the delay that were accumulated between the end of March and May. We may have some really negligible shift but we've been super focused on making sure that there were no implication on 2021 and therefore, on completing CAPEX that we were targeting to complete and do in 2020. So



at the current...for the time being, I don't see any implication or consequence on 2021. And I don't think again it's the right place where to comment guidance for next year. You will be hearing that soon in November.

On net debt, what I said is that we confirm our €12.8 billion net debt full year guidance. There is a working capital negative effect of €0.1 billion. So we are effectively confirming what we said that in July we have no changes. Although, as I said during my description, there may be some very marginal increase in the undercharges at the end of the year, but we're talking about €10 billion and something that on a €12.8 billion is not going to make any difference.

OPERATOR: Ms. Pasini, there are no more questions registered at this time.

ALESSANDRA PASINI: Thank you very much to all of you for participating to this call and for your questions.