



## **Conference call Transcript – Release of 2012 Audited Consolidated Results**

Good morning America and good afternoon Europe,

Welcome to Hrvatska elektroprivreda d.d.'s first investor relations conference call.

My name is Ivan Matasić and I am Board Member and the CFO of HEP.

We planned to centre this call around HEP's 2012 audited financial results, but in addition we'll provide you with an update on our trading activities post November 2012, the date of our Eurobond issue, as well as discuss our views for 2013.

We will reserve some time for Q&A session at the end of the presentation, when you are welcome to ask any questions you might have.

As you have seen from the call invitation we sent earlier this week, we will base this call on a Power Point Presentation which is posted on our web site. I hope you managed to access it.

I will skip the first few slides on the Company overview as most of you are familiar with it and start at slide 8, which deals with generation activities.

As some of you may remember, as explained during our road show process in October last year, Croatia was affected by a serious drought throughout 2011 and most of 2012, of such severity which has not been seen in the last 50 years.

Because of the effect on our hydrological production assets, during this period we experienced an increase in operating costs, mostly due to the purchase of electricity, natural gas and fuel oil, all of which will be covered in more depth later in the presentation.

However, the hydrological situation drastically changed in the last quarter of 2012 and continued to improve throughout the first four months of this year, which led to full reservoir accumulations.

As shown in the bottom right hand chart on slide 8, HEP's production generation significantly improved in the first quarter 2013 (by 211%) as compared to the same period in 2012.

Moving on to slide 9, we provide general information about transmission, distribution and sales activities.

Transmission and distribution of electricity are fully regulated activities with a stable and predictable revenue stream.

The latest electricity and gas tariff increases took effect in May 2012, by 18.9% and 20% respectively, while thermal energy tariff increase took effect in December 2012 by 36.8%. The full effects of these increases will become apparent this year, although have already resulted in 7.1% higher income in 2012 compared to 2011.

HEP has more than 2,3 million end customers, and in terms of volume of electricity sold, HEP is the primary electricity supplier in Croatia, with 98.6% market share.

In thermal energy, we cover 84% of the district heating market. The chart in the bottom left corner of slide 9 shows electricity prices for domestic consumers compared to other European countries. This gives us comfort that Croatia's pending accession to the EU will not prevent us from retaining our market share.

It is important to emphasise that we have the right to apply for tariff increase to the Croatian energy regulatory agency (HERA) once a year, if business conditions and operations merit, for example in case of a more ambitious capex plan or to account for higher operating costs.

Since the end of last year the Croatian Government supported the Act on Regulation of Energy Activities and granted HERA broader authority in the field of price setting and policy approval.

This broader authority falls within the framework of harmonizing Croatian legislation with the Third Energy Package of EU legislation.

Slide 10 shows what we believe to be, a very favourable and low cost generation asset mix, with 50% of installed capacity coming from hydro power plants. Although subject to broad weather trends, the production of energy/electricity from hydro plants represents a cost efficient and renewable source of energy.

Moving to the next slide (no. 11), we outlined key initiatives in the forthcoming years.

- We anticipate investing in new generation facilities (mostly hydro and thermal) to add approximately 1,6 GW of capacity and refurbish existing assets to add approx 155MW of capacity.
- The largest project currently in progress is Plomin III, which is a 500 MW coal thermal power plant. Once this plant is on line, it will decrease our dependence to hydrology conditions. We anticipate operations will commence by early 2019.
- We plan to upgrade and expand transmission and distribution networks to accommodate for increase in demand and market liberalisation as well as to minimize network losses
- We will focus on improving operating efficiencies and our cost structure, by centralising and standardising public procurement and purchase, as well as by reducing headcount, which we'll discuss in more depth a bit later when we cover the "Restructuring" section.

- We believe we can improve customer service by bringing new products and services to the market, actively working on the image and perception of the Company, and broadening our traditional customer base.  
One new product we are very excited to be bringing to market, introduced by HEP Opskrba, is ZelEn – Green energy, obtained exclusively from HEP's hydro power plants that are certified by the German Certification company TÜV SÜD for production from renewable energy sources

Coming back to our initiative on building up our generation facilities, slide 12 shows major projects, by type and size (in capacities and funds needed), which HEP expects to undertake over the next 7-8 years. When finalised, such capital investments should result in an additional 1,777MW of generation capacity, which would represent an increase of 43% over the current level.

This increased generation capacity will enable HEP to be completely self reliant in electricity production, covering all Croatian demand and opening a new window for a greater volume of exports.

Of course such plan is subject to modification, depending on future business operations and results, Government support and feasibility of the individual projects. We estimate that approximately 50% of the stated investments represent committed expenditures, while the remaining 50% represent non-committed capex which can either be deferred or even cancelled depending on facts and circumstances.

Now, let's discuss 2012 financial performance.

On slide 14, you can see that 2012 **total operating income amounted to HRK 14,0 billion**, which represents a **7.1%** of increase (or HRK 931 million) compared to 2011. Such increase is mainly the result of:

- 8% growth in revenues from electricity sales (or HRK 860,4 million) coming from increase in prices of regulated activities and application of new price calculation methodology for eligible customers of HEP Supply company and larger sales to the foreign markets mainly in 4Q 2012
- 0.5% growth in revenues from thermal power sales (due to impact of price increase of 36.8% at the end of 2012)
- 3.9% growth in revenues from gas sales, resulting from 20% increase in selling price and
- 3.9% growth in other operating income primarily due to increase in income from network connection services and income from inter-compensation mechanism of HEP-Transmission System Operator.

Turning to slide 15, first let's briefly look into our expenditures for the year. As we have mentioned previously, extremely adverse hydrological conditions in 2011 and most of 2012 resulted in an **increase of Total operating expenses by over HRK 1 billion (which is 7.97% YoY growth)**. This increase is due to 930 Gwh of electricity purchased in the market

(i.e. imports) and from a significant increase in the price of commodities HEP uses in its generation facilities. Average price of natural gas increased by 31% YoY, while the price of fuel oil increased by 21% YoY, all in comparison to 2011.

Lastly, in line with our Management Restructuring Program and a planned decrease in our workforce, HEP made reservations for severance payouts of HRK 250 million.

As a net result, at the end of 2012, HEP delivered a consolidated profit of HRK 71.2 million.

Moving on to slide 16, as we have already mentioned, the effects of our customer price increase begun to show results.

Nonetheless, the full effect will only be observable at the end of 2013. Despite challenging conditions in 2012, we maintained EBITDA level at HRK 2,1 billion and EBITDA margin of 15%, in line with 2011 and we kept in compliance with all agreed financial covenants as of 31 December 2012.

#### Slide 17 shows **Revaluated and optimized CAPEX at level of HRK 2.6 billion**

Capital expenditures amounted to HRK 2.6 billion, with 22% increase compared to 2011, including HRK 1.5 billion for transmission and distribution network renovation and new facilities, and HRK 0.9 billion for refurbishments and renovations of existing power plants.

We don't envisage any dividend payout for 2012, in line with Governments approach to reinvest the delivered consolidated profit into the new investments.

To further improve Group's liquidity position, we are in discussions with our lending banks to extend our existing short term credit lines into medium term lines.

On slide 18 we wanted to emphasise the positive effects of our successful 2012 Eurobond issue.

As specified in the Terms and Condition of the Notes and communicated to you during the road show, HEP followed through on our pledged commitments, including:

- Repayment and prepayment of all long term debt specified in the Prospectus (clause 4.2), in total amount of EUR 163 million, and
- The remaining part of the bond proceeds, of EUR 230 million, was used for financing capital expenditures and other general corporate purposes in 2012 and 2013

In addition, our liquidity position was stabilised, with significant improvement in HEP's debt structure. Short term borrowings have been reduced by 32%, while long term borrowings have increased by 23%. More importantly, we have extended our overall debt maturity profile and decreased our annual repayment obligations to more prudent levels. As of 31 Dec 2012, we had access to approximately HRK 2,2 billion of unused committed facility lines, out of which HRK 900 million relates to short term revolving framework facilities and HRK 1,3 billion

of long term loans connected to specific projects (EBRD and commercial banks line for HPP Ombla and KfW funds for Renewable energy projects). On the other hand, also as of 2012 year end, HEP no longer has Government guaranteed loans in its portfolio, which gives us more flexibility for future financing arrangements.

Furthermore, HEP's Management Board is focused on continuing to improve our debt profile, which we hope to be recognized favourably in our future credit ratings.

Moving to slide 20, we outline recent developments in the field of corporate optimization and unbundling of transmission operations.

As we discussed with you previously, unbundling of our subsidiary HEP-Transmission System Operator, was envisaged to be done in accordance with the Independent Transmission Operator model (the ITO model). On April 9<sup>th</sup> 2013 the Assembly of Hrvatska Elektroprivreda d.d. reached the decision on unbundling according to such ITO model.

The present company HEP – Transmission system operator d.o.o. will be transformed to an ITO in practically the same form as today. This new transmission system operator shall be named: Hrvatski operator prijenosnog sustava d.o.o. – Croatian Transmission System Operator d.o.o (hereinafter: HOPS d.o.o.).

We'd like to highlight a few other points that strongly support keeping of transmission system operator within the HEP Group, naturally with strict application of the independence rules prescribed by the above stated regulations of the Republic of Croatia and the European Union.

Transfer of assets to HOPS d.o.o. according to ITO model would have no impact to contractual consolidated financial indicators by existing investment loans (since future financial reports by HOPS d.o.o will in the same manner be consolidated in the reports of HEP Group).

Certification process is under control of Croatian Regulatory Agency for Energy (HERA) which is involved in all current activities of HEP's restructuring teams and has been provided with the documentation prepared that will form an integral part of the Request for Certification. Request for Certification of the ITO model should be submitted in May 2013.

Just to mention, we are applying the same model of unbundling as was applied by Austrian Verbund, Hungarian MVM, French EDF, Danish Energinet, etc.

Finally as we wrap up, allow me to say just a few sentences on our outlook on 2013.

In 2013 we anticipate an increase in operating revenues as compared to year 2012 as a result of the remaining effect of the increase in regulated electricity and gas prices as of May 2012 as well as a result of the increase in thermal energy prices as of December 2012. Taking into consideration the situation in economy we do not expect any increase in electricity consumption in Croatia.

We also anticipate increased electricity export - due to the extremely favourable hydrological conditions in the first quarter of this year, which will contribute to the increase in revenues.

Increased electricity production at hydro power plants (at which already in the first quarter 2.6 TWh was produced as compared to 4.8 TWh during entire 2012) will enable lowering the volume of imported electricity and consequently lowering of costs as compared to year 2012. In 2013 HEP started to acquire CO2 emission units, however, considering the large portion of the production capacities (both hydro power plants and nuclear power plants) which do not emit CO2, the influence on the cost increase will not be very significant.

We expect to see a decrease in costs of salaries and other employee benefits due to a reduction in employee headcount. We've already seen a 10% decrease in the first half of the year due to restructuring in HEP Transmission System Operator and HEP Distribution System Operator.

We are planning investments in the amount of HRK 2.4 bn, of which over 40% will be related to the investments in the transmission and distribution network, and over 40% in the reconstruction and revitalisation of the existing power plants and the preparation of the construction of the new ones.

With this I would like to thank you very much for your attention and would move to Q&A part of this conference call. May I please ask the operator to open the call for questions.

After the Q&A session:

If there are no further questions I would like to once again thank all investors, banks, rating agencies and other partners of HEP, for your attention and wish everybody a nice day.

We will now end this conference call, and would like to instruct you to refer to our web site: [www.hep.hr](http://www.hep.hr) where you will find contact details for any further inquiries.

Best regards from Zagreb.

Please note that the questions asked on the call will be provided to you on the separate link in the week of May 06th 2013