



HRVATSKA ELEKTROPRIVREDA

The YE 2016 results conference call
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OPERATOR: This is Conference #34487155.

Operator: Good afternoon, and welcome to today's 2016 Financial Results Investor Call. If you wish to ask a question during today's call, you will need to press star and 1 on your keypad. I must advise you that this conference is being recorded today on Wednesday, the 7th of June, 2017.

I will now hand over to Ivana to introduce your call. Please go ahead, Ivana.

Ivana Sučić Funko:

Thank you. Ladies and gentlemen, greetings from Zagreb. We are happy to welcome you to our 2016 audited financial results presentation. Today, our CFO Mr Rosandić will take you through the highlights of our business and financial performance in 2016 using presentation materials. As we informed you in our Investor Call Invitation, the presentation materials are available on our corporate website under „investor relations“ section both in English and Croatian, and we hope you have them in front of you. We estimate that presentation would last around 30 minutes, after which we would gladly answer questions you might have.

Before we start, let me draw your attention to the harbour statement on **slide 3** of our presentation. Now, allow me to introduce Mr Tomislav Rosandić, our CFO, who will outline our company's performance in the period ending December 31st 2016.

Tomislav Rosandić:

Hello, everyone. Thank you for participating today. I am happy to be here with you this afternoon together with my colleagues from Finance and Controlling Department, EU and Regulatory Affairs Department and HEP Trade, to inform you about our 2016 performance.

I would like to start the presentation from **slide number 4** by mentioning key highlights of 2016. In 2016 HEP Group fully fulfilled its mission of safe and reliable supply of customers with energy. In February last year the certification of HEP TSO under the ITO model has been finalised successfully. In June 2016, the Collective Agreement has been signed with trade unions representatives which reflects a continuous good relationship with Company's social partners.

Last year, in July, a dividend pay-out of 607 million Kuna was made. In October, Standard & Poor's upgraded the stand-alone credit profile from b+ to bb, and overall corporate credit rating from BB- to BB reflecting active corporate management of HEP's financial position and overall business activities.

In November 2016 HEP fulfilled legal requirements for unbundling distribution from public supply under the Energy Act by establishing the new subsidiary HEP Elektra – a legal successor of HEP DSO which will be explained in more details later on.

In 2016 HEP continued its presence in the region: in Bosnia and Herzegovina, Serbia, Kosovo and Slovenia where the Company acquired 12.5% electricity market share in commercial sale. HEP's 85% share on the Croatian electricity market was strong and stable.

As to investments, total CAPEX for 2016 was around HRK 2.5 billion. At the end of 2016, the Group employed a total of some 11.8 thousand workers.

Moving to slide 5, you can see key facts of our financial performance in 2016. HEP Group has achieved the extremely good result third year in a row with consolidated net profit of 2 billion Kuna (that is approximately around 300 million euros) which represents a 5% increase compared to year before. In 2016, the Company retained its strong liquidity with a cash position of more than 3 billion Kuna. HEP's net debt was 2.2 billion Kuna, marking a decrease of 28% due to repayments of loans and domestic bonds as well as the increase of cash position.

The total of 2.6 billion Kuna in CAPEX were invested mostly into the reconstruction and revitalisation of existing energy facilities, construction and preparation of the construction of new energy facilities as well as into connecting customers. All investments were financed by the cash flow from operations.

Moving to next slide 6, let me address a couple of key figures related to performance in natural figures: Electricity generation in 2016 was 8% higher compared to the year before. Due to a relatively mild winter, heat sales were 1% higher. The sale of gas to retail customers in 2016 was 1.32 TWh which represents a 10% increase compared to 2015. Gas wholesale, which HEP operates since April 2014, was 4% higher than the year before.

Starting from slide 8, we'll discuss the 2016 financial performance.

You can see that in 2016, operating income amounted to 14.4 billion Kuna, which was a decrease of 1.2% (169 million Kuna) compared to year before. The revenue from electricity sale increased by 294 million Kuna (around 3%), which was a result of an increase in foreign market revenue by 364 million Kuna (8,3%), an increase in revenue from HEP's producers in the incentive system of generation from renewable energy sources by 125 million Kuna.

The revenue from thermal power sales increased by 17 million Kuna which was around a 2% increase compared to the year before due to a 2% higher average price and the consumption increase of 0.6%.

The revenue from the distribution sale of gas to customers decreased by 45 million Kuna (around 11%) as a result of a lower sale tariff (lower 12.6%), whereas the sale in volume increased by 9%.

The revenue from the sale of gas on wholesale market decreased by 196 million Kuna (around 15%), when compared to 2015 due to the lower sale tariff (lower 15.1%).

All other operating income was reduced by 240 million Kuna (c. 14%) compared to 2015, when revenues from the claim against the Republic of Slovenia for undelivered electricity from nuclear power plant Krško in the period between 1 July 2002 and 19 April 2003 was realized.

Moving to slide 9, in the upper left hand side chart, you can see that in 2016 operating expenses amounting 11.7 billion Kuna, were 1% higher compared to previous year, as a result of: increase of electricity import due to higher sale on the wholesale market, supply of customers in the region and the increase of electricity sale to domestic customers, which increased the expenses of electricity procurement by 205 million Kuna (around 11%).

As it is shown on the chart in the upper right hand side, in 2016 fuel costs decreased by 251 million Kuna (around 14%) as a result of lower gas prices, lower coal prices and the termination of the use of fuel oil. Furthermore, the costs of gas sold on the wholesale market decreased by 106 million Kuna i.e. by approximately 8% whereas all other operating expenses increased by 365 million Kuna (around 12%) primarily due to provisions for severance payments based on the termination of employment amounting to 343 million Kuna for the planned restructuring of HEP DSO in 2017.

In 2016, the structure of revenues, the same as for expenditures, remained relatively stable compared to the previous year.

Moving to slide 10, as we have already mentioned, the liquidity position in 2016 remained strong and stable with cash position at the year end of 3 billion Kuna, which is approximately around 400 million euros and additional liquidity of 1.4 billion Kuna of undrawn bank lines under short term financing sources as the liquidity reserve.

On the slide 11, in the upper left hand side chart, you can see that the Company continues to be relatively low leveraged with net debt to EBITDA ratio of 0.5x at the end of period. Although debt currency structure presents 98% of debt exposed to EUR, by Croatian National Bank providing foreign exchange policy where HRK is strongly related to EUR, the actual risk is relatively limited.

In 2017, the remaining amortising domestic bond and outstanding 16% of the 2012 eurobond is due to for repayment.

Moving to slide 12, let us first say that HEP has been the first company in Croatia asking for credit rating from Standard & Poor's and Moody's, way back in 1997. Since then, Standard & Poor's revises HEP's credit rating every year whereas relationship with Moody's was continued in 2011.

In October 2016, Standard & Poor's upgraded the stand-alone rating of HEP from b+ to bb and HEP's overall corporate credit rating from BB- to BB, thus aligning it to the sovereign rating of Republic of Croatia. Furthermore, in December last year the same agency revised its outlook on the Republic of Croatia to stable from negative and revised its outlook on HEP from negative to stable as well.

The later was followed by Moody's confirmation of long-term Ba2 corporate rating and revision of outlook to stable, in March 2017.

This brings us to Operations results section.

On the slide 14, in the upper right hand side chart you can see the geographical position of power plants HEP operates across the Republic of Croatia. The upper left hand side chart shows generation performance of power plants with a higher generation of thermal and hydro power plants as well as nuclear power plant Krško (which is co-owned with Slovenian GenE). Due to a relatively mild winter, generation of heat energy was 1% lower compared to the year before.

As you can see from the chart in the bottom left hand side, HEP operates a large and diversified generation mix with 4.388 MWe of installed capacities which represents 89% of total installed capacity in Croatia in 2016. Generation is largely based on hydro and nuclear power with limited CO₂ footprint and a reduced exposure to commodity prices. Even though subject to weather conditions, the production of electricity from hydro power plants represents a cost efficient and renewable source of energy.

Moving to slide 15, you can see that 2016 was marked as a hydrological good year with 8% higher hydrology than the year before, and 12% above average hydrology.

Since hydro power plants account for 50% of installed capacity, there is a certain hydrological dependence which Company takes effort to mitigate by prudent energy balancing and system optimizing. As it is seen from the bottom left hand side chart, certain improvements have been made. Comparing 2011 and 2012- extremely low hydrology was reflected in lowered EBITDA whereas in 2015 and 2016 EBITDA was higher for the same hydrological levels in the past years.

80% of total hydro installed capacities derive from the accumulation HPPs which gives certain possibilities of using the water energy balance during whole year compared to the run-of river hydro power plants where there is no possibilities of storing water in accumulation.

On the next slide 16, you can see that thermal power plants generation in 2016 was 15% higher compared to year before. Although, as you can see from the upper right hand side chart, 47% of thermal installed capacities in 2016 are those that run on crude oil, when optimising generation portfolio balance, thermal power plants generating electricity, were those that run on gas and hard coal. Crude oil-fired capacities serve only as reserve capacities due to uncompetitive prices. Thermal power plants fired by hard coal provide a stable base load source of electricity, while gas-fired power plants are all CCGT capacities producing heat as well and used for thermal and heat supply, which is seen from the bottom left hand side chart.

Moving to slide 17, the upper right hand side chart shows the Croatian transmission system which is one of the 5 best connected transmission system operators in Europe. Through continuous long-term investments into the transmission network, i.e. cross-border transmission lines, TSO (HOPS) accomplished great and almost infinite capacities (from the perspective of needs and use of the same capacities/power) towards the interface with the CEE region (Hungary and Slovenia) that represents the major part of total cross-border transmission capacities at the Croatian borders (66.61%).

Furthermore, when we talk about transmission network losses, they are around very competitive 2%. They do vary during the season due to a series of factors, such as: system load, temperature, hydrology, topology of the network itself etc., but overall they are at competitive levels compared to surrounding transmission systems.

Also, HEP TSO is 50% owner of the Croatian Power Exchange- CROPEX, together with HROTE. Croatian Power Exchange acts as Central Counter Party between sellers and buyers of electricity and takes the risks of buying and selling electricity for all day-ahead and intraday trades concluded on the trading platform.

Moving to slide 18, let us say a few words about distributions system. HEP DSO is a sole distributor of electricity in Croatia- regulated monopoly activity, performing after November 2016 role of distribution system operator which will be further explained on next slide.

Distribution network losses are decreasing over time due to investments into modernisation and reconstruction of distribution network. A couple of years ago, distribution network losses were higher than 10% and as you can see from the upper left hand side chart, total network losses were around 7.6%. Total network losses comprise technical and commercial losses where technical losses are related to network performance and commercial losses derive from unauthorised usage and inefficiency of network management.

HEP DSO with 7.5 thousands employees, the largest subsidiary of HEP, in 2016 continued its process of restructuring, expecting significant savings in operational expenses and improvements through more efficient organisation.

Moving to next slide 19, In November 2016 HEP successfully finalised the unbundling process of distribution and supply activities inside HEP DSO and therefore fulfilled the obligation set under the Amendments to the Electricity Market Act. The process was done with great efficiency facing neither technical problems nor customer outflow.

Since November 2016, HEP DSO performs the role of distribution whereas the role of customer under public service obligation (universal service and guaranteed supply) is carried through HEP Elektra- a legal successor of HEP DSO. HEP DSO continues to carry out metering, consumption billing, metering point maintenance and other field activities. All customers supplied by HEP DSO to-date will continue to use supply service under the same conditions as before under the supply of HEP Elektra.

On the slide 20, in the upper left hand side chart, you can see that HEP's electricity market share is 85% in 2016. The customer outflow that HEP was facing during 2014 was stabilised and has remained at these levels since 2015. HEP Elektra supplies customers under public service obligation (universal service and guaranteed supply) while HEP Supply supplies all other customers opting for a market supplier.

When talking about households supply, HEP's market share in 2016 was 91% out of which 89% is under service and 2% under market supply which shows the trend where households seem to be more loyal customers valuing security and price stability compared to commercial customers who are more willing to accept open market prices, and therefore face price volatility. HEP's market share in commercial supply in 2016 was 81% out of which only 7% was under universal supply and 74% under market supply. In total around 93% of commercial sale in Croatia in 2016 was under market supply confirming the above mentioned.

In 2016, HEP continued its regional expansion in the region, especially in Slovenia where HEP holds 12,5% market share in commercial sale, by this compensating loss of market share in Croatia.

Coming to slide 21, you can see that in the electricity market in Croatia, electricity demand in 2016 was by 1.5% higher compared to the year before. Furthermore, in 2016, HEP's electricity needs were 12% higher compared to 2015 due to higher electricity sale abroad which were in 2016 3.673 GWh compared to 1.853 GWh in 2015.

Moving to slide 22, let us say a few words on gas business. HEP Group provides activities of gas distribution and gas supply on retail market through its subsidiary HEP Gas and since April 1, 2014 it acts as a sole wholesale gas supplier under regulated terms to public service suppliers for household customers providing reliable and safe gas supply in Croatia. Deregulation of gas price for public service supply (households) has been postponed until April 1, 2018. Also, worth mentioning is 60% of Standard bundled units of the Underground Gas Storage allocated to HEP Group until April 1, 2022 and HEP was chosen as the balancing service provider for the current storage year (April 1, 2017 – March 31, 2018) in tender procedure organized by transport system operator Plinacro.

On the other hand, HEP Gas is the second largest gas supplier out of 55 gas suppliers in Croatia by volume sold to end-customers and in the same time the second largest gas distributor out of 35 gas distributors in Croatia.

On the slide 23, in the bottom right hand side chart you can see the geographical footprint of district heating systems across Croatia where red dots represent HEP's district heating systems being the largest distributor of heat covering approximately 91% of the total market by the number of customers in Croatia. Looking at the chart at the bottom left hand side chart, you can see that in 2016, HEP's sale of heat energy was 91% accounting for 5% of revenue share of the overall Group's revenue.

Before moving to Capital Expenditures, on [the slide 24](#), let us say few words on other HEP's operations. In 2003, HEP established subsidiary HEP ESCO as implementing company for energy efficiency programs providing activities of development, implementation and financing of ESCO (energy service company) projects that are repaid from savings, where customers find additional value added. Providing this additional service to the customers, HEP ESCO represents a cross-selling channel for improving customer relations and developing the benefit program with electricity, gas and heat supply.

An important role of optimisation of power plants operations is carried out by HEP Trade, subsidiary performing trading activities on markets in the region as well as via bilateral trading in countries across the region. Except from electricity trading (including reservation of cross border transmission capacities), HEP Trade is trading emission units, green certificates, gas sale and reservation of the transport system capacity. Spot and futures trading is performed on European energy Exchanges (BSP Southpool, HUPX, EPEX, EEX, CROPEX, SEEPEX, CEGH) and broker platforms (TFS, Spectron).

HEP Group is present on wholesale electricity markets from Germany to Kosovo, directly in EU members' states or through HEP-Trade's daughter companies in Bosnia and Herzegovina, Serbia, and Kosovo. HEP Group is also active on the retail markets of Slovenia, Serbia and Bosnia and Herzegovina (electricity supply).

In 2016 HEP Trade traded 8.6 TWh of electricity in Croatia whereas in Bosnia and Herzegovina volume traded was 1.2 TWh. Also, in 2016, volume traded with Slovenia was 435 GWh, with Serbia 111 GWh and with Kosovo 29 GWh.

[Moving to slide 26](#), brings us to capital expenditures. In the last few years Company provided on average 2 – 2.5 billion Kuna in CAPEX per year. In 2016, total investments amounted to 2.6 billion Kuna which is a 2% increase compared to 2015, including 1.6 billion Kuna for transmission and distribution network renovation, as well as 694 million Kuna into power plants facilities.

As to future investments, the revitalisation plan for hydro power plants is ongoing expecting 140 MW of additional capacities. As for the thermal power plants, plans are aimed in line with low CO₂ emissions where a two phase tender for the EPC Contract for the reconstruction of EL-TO Zagreb CCPP is undergoing.

With this I would like to thank you very much for your time and attention and would move to Q&A session of this conference call.

Ivana Sučić Funko: Mr Rosandić, thank you very much. May I please kindly ask the operator to open call for questions?

Q&A's session:

Operator: Thank you. And as a reminder, if you do wish to ask a question, you can press star and 1 on your keypad and wait for your name to be announced. Star and 1 on your keypad for any question.

We've got no questions on the phone lines. Please continue.

Ivana Sučić Funko: If there are no further questions, I would like to once again, thank all participants 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 where you'll find contact details for any further inquiries.

On behalf of HEP Team, best regards from Zagreb!