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EDITED TRANSCRIPT

CEN.NZ - Half Year 2019 Contact Energy Ltd Earnings Call

EVENT DATE/TIME: FEBRUARY 10, 2019 / 9:00PM GMT



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PRESENTATION

Dennis Barnes - *Contact Energy Limited - CEO*

(technical difficulty)

disclaimer. I'll tell you who's in the room. To my left, I've got Dorian Devers or Devers, you decide. And Dorian, new CFO, his inaugural results presentation and he's getting credit for the results. In the room, we've got Matthew Forbes, who you all know; Catherine, who runs corporate affairs; and Louise, our Head of Capital Markets. We'll go through the presentation, and I'll [pass it on to] (inaudible). We'll then go to questions and (inaudible) and then we'll do a round-robin and see if there's any more tidying of (inaudible).

As far as the results themselves. Just in the year, first one being fairly important year for us in that first strategy element of ours, which is renewed optimization of our portfolio, and that concluded with the sale of our Ahuroa and Rockgas LPG business. Clearly, sharply stronger earnings and cash flow. I think I've said in mid-2017, we're beginning to see the supply-demand outlook changing somewhat. (inaudible) in our portfolio for that circumstance. And we saw through the higher price period, driven by the lower hydrology and gas field outages that our Generation business performed really well.

(inaudible) path point which we knew we would come to a few years ago when we went on this path. And we knew the conclusion of that (inaudible) the revised dividend policy, which was announced today. [Strength] of the balance sheet, our future view on earnings, with increasing the ordinary dividend payout to 100% of operating free cash flow, and that means \$0.39 for this year, significantly up on the prior year. Now you'll all be wondering, and we'll come to it through the course of the presentation, what are the conditions around that dividend policy. But it is an expected (inaudible) free cash flow payout based on expected earnings. We don't intend to vary the dividend if we have the normal variability that we have in our business of CapEx and hydrology. Any (inaudible) free cash flow, which is from performance (inaudible) reasons, we would signal through the dividend. The policy is to look through any short-term variabilities in (inaudible) cash flow that might come from CapEx and hydrology. So the real target is stability in that area.

That's really the conversation around the next slide. We're moving from 80% to 90%, and we have that almost (inaudible) while we were bringing down the debt level. The debt level is now (inaudible). And as I've just said, we'll move to 100% on operating free cash flow payout, which the board is really interested in maintaining stability around.

The highlights of the 6 months. We'll continue to maintain financial discipline with both OpEx and CapEx. There's sharp improvement in customer advocacy, NPS metric, which I've always said is an often good performance when retail business is up. We've got great safety in the 6 months. Clearly, the disposal of Rockgas LPG, which had its own hazard contributed to that, but we had 0 injuries in the first half. And a continued trend on engagement. And as I've mentioned, in terms of shareholders, the stakeholder group that we largely talking to this week, a 23% increase in the interim dividend.



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We expect those operational improvements to continue, so we've given your targets for OpEx and CapEx in fin year '19 and fin year '20. Still confident that those are achievable. Safety, I mentioned customer advocacy and engagement. I think they're the cornerstones for that good performance, and you can see all of that together has increasingly resulted in operating free cash flow that's been [returned to] shareholders.

In terms of (inaudible) and all the positive news flow on decarbonization and what that might do for demand. Demand is in its 10th year of being flat, and we've seen a little variation in the 6 months with the introduction of the fourth potline at the smelter while irrigation demand was significantly lower.

Residential demand did increase. You might not believe it this week but that was on the back of lower average temperatures in the month -- in the 6 months, sorry.

If we think what does all of that mean and what are the indicators of what does this upcoming (inaudible) look like, we have seen a rise in storage levels. But I think that the chart here, particularly at the bottom, do show you how variable the storage and hydrology has been. If you look at those bullet marks of the first half '18 and the first half '19 and look at the variation in rainfall and then look at the bottom right chart and you can see the variation in North and South Island storage. And I think we're beginning to see a more normal, more like mean pattern.

Obviously, a big news in the 6 months was fuel scarcity. We had major outages at New Zealand's largest gas field which has planned maintenance, today was just coincidental. We saw the market respond to that; as in the market worked. (inaudible) fuel, particularly gas fuel, have a material impact (inaudible) market and the market showed that through price. (inaudible) obviously, a huge amount has changed. That doesn't (inaudible) today as there was last September, albeit for a few months of production. We've seen the new major operator in New Zealand, being OMV, announce an investment program. And I think as we get through this Pohokura outage for the next 2 months, I think we'll see a more normal gas availability levels. But the story in my mind is that, that reliability that we need from gas, which wasn't there, is being signaled through the electricity price (inaudible) some response to that in terms of investment and contracting.

The strategy has not changed. Continue to focus on being a really top retailer with a safe and [efficient] generation business, looking forward to decarbonize New Zealand. We'll always be underpinned by disciplined and transparent approach to costs, and we took another level of transparency in the last few months which, for those of you who make models out of our numbers, is probably a bit painful. But we are probably the most transparent of the (inaudible). And we can't optimize our portfolio of assets forever, so we'll probably see less activity on that over the next year or (inaudible). Whether that strategy will last in terms of what you should see and what has happened in the 6 months, we, in the retail business, have -- excuse the language -- gone almost fully agile, which actually is (inaudible) difference in this market which has an amazing cadence. (inaudible) result in lower call center volumes, much improved digital interaction with us, lower ICT costs (inaudible) [call centers] gone to the cloud and more and more customers using the app.

Now if you're a customer, you think, well, that's all very nice but what does it mean for me? In the last 6 months I think you've seen product suites developed by (inaudible), allows all customers to be able to (inaudible) best deals well and provide a lot of (inaudible) control to those customers.

(inaudible) business, we've reorganized a little bit as we mentioned in the Strategy Day in November and in the full year results. The commercial and industrial (inaudible) wholesale business, very much with a target to assist when businesses want to decarbonize. Obviously, that's a long-term gain, some limited successes in the year. You will have seen us receive eco funding. (inaudible) businesses transform their fleets to electric vehicles. But probably the biggest progress in the 6 months which we outlined in November was the range of development up at Tauhara, which is looking like a very competitive asset. But of course, not for development right now.

So with that, a bit of a runaround, the strategy the last 6 months and what that means for shareholders. Dorian will take you through a bit more of the detail, and then I'll come back to a few forward-looking statements. Dorian?

Dorian Kevin Thomas Devers - Contact Energy Limited - CFO

Thank you, Dennis. It's great to [give] my first (inaudible) results presentation. And actually, (inaudible) it's such (inaudible) quite disappointing that I can't take any credit for these set of financials which, being honest, I wasn't expecting to be presenting yet (inaudible) coming into Contact.



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Dennis has already mentioned, there have been a number of changes to our reporting. We've done it for the right reasons, aligning of that natural reporting to the new business structure with C&I going into wholesale; plus, we've made some other changes which I think make our business a lot more transparent. I think it was relatively transparent anyway. And (inaudible) Head of Investor Relations. (inaudible) due diligence on Contact ahead of joining because it would've saved me a lot of time and effort.

So about on to the (inaudible) a good underlying performance but also profits were made on disposals so they just [emptied] Rockgas. We like to talk in context in terms of the biggest performance on a continuing, a underlying perspective, because that gives the best insight into what's actually driving up performance. If I just sort of step you through how you get there from the outside to the side, the first thing we do is we adjust out Rockgas, which was discontinued. Big adjustment in FY '19 because you've got \$167 million of profit on disposal there. You then back out non-underlying topics, which are the same similar ones that we have normally but we also have the \$5 million (inaudible) in the FY '19 number. And that being diffused to, what we call, continuing underlying earnings, which is up by \$49 million as you can see on the slide. \$61 million of that is EBITDAF. We'll talk a bit about that in the next few slides. Processing well at depreciation. We don't have, I guess, our balance sheet anymore. Lower interests costs you'd expect because of the proceeds that we've got in for those (inaudible). We (inaudible) from higher tech, [higher] profit. So effective tax rate on our continuing underlying business. It's in line with the statutory tax rate, the 28%, so there's not (inaudible) in there. So, on to EBITDAF. Bit of performance, the costs are 3 businesses, and corporate's not really a business it's in there for completeness. First thing to say, it's good to see both wholesale and customers showing EBITDAF improvements. You can see the real driver of the growth is around the wholesale business. I should make the point that we came off a dry H1 FY '18 and actually with a move back to mean hydrology our EBITDAF grew by \$25 billion dollars. The fact that we've grown (inaudible) I'll talk about in the next few slides.

So in terms of our Generation costs, they're down by \$12 million, and the key thing here is they're down by \$12 million but we've still got the same amount of Generation available. And what's happened there is we've seen more renewable generation, and that's allowed us to substitute out the more expensive thermal and acquired generation. You can see that neatly on the chart from the left side. Hydro is up considerably; it's up with -- above mean. You can see that geothermal has dropped back up a little bit. There's no structural changes or anything going on there, just the Wairakei for yearly inspection which happened in the first half of year. That's now complete, and you'll see thermal go back to normal.

But the thing I like about this slide, if you look at the chart in the middle, (inaudible) renewable costs had gone from \$60 million in the first half of last year down to \$59 million. There's a bit of productivity in there that, to all intents and purposes, are renewable (inaudible) fixed. We got all of that extra generation for free, which is why, as you know, we got so excited about it when it rains.

In terms of our [contracted revenue], that's up about \$7 million year-on-year. I'll talked to the \$7 million first because that actually relates to the non-electricity part of the business. We're seeing (inaudible) revenue lead to higher volumes but also higher pricing. And it's good to see (inaudible) the higher cost of carbon there. And in terms of the other income, that's up and that largely relates to our voluntary market-making obligations with the ASX, where we're in the money this year, we're out the money last year.

In terms of the actual electricity revenue, that's flat but there's still offsetting things going on here. What we've done for C&I in particular, with it being the fixed-price, variable-volume part of our business, with the risk (inaudible) natural gas supply, we took the decision to pull back from that business a little bit. From a risk mitigation perspective, it's proven to be a good decision financially as well as it freed up volume for us to go long in terms of merchant capacity. And (inaudible) energy (inaudible) that we're seeing in the market in the first half of the year. So what you can see, the exciting things going on here, is you're seeing lower revenue from those fixed-price, variable-volume businesses, but that's offset by higher revenue from our CfDs, so we are supporting Tiwai (inaudible). Volumes are going up there, but also we're seeing higher pricing as well, in particular, led to some short-term CfDs that we've got in place, supporting other generators who would run short at times when the prices were high. I wouldn't be forecasting that those prices on CfDs were going to continue into the future.

And then where the big improvement across our wholesale business [is, is around] trading. We've seen the EBITDAF go up by \$39 million. I've tried to actually move this a little bit for you here because it's obviously a significant number. And if you (inaudible) just going over the trading, the buying and selling with the grid. Sometimes, we're long. And when we're long, the sales (inaudible) sales channel to market. Sometimes, we're short. And when we're short, in effect, we're buying Generation to support our business. And then the balanced trading, the buying and selling that's happening in the middle, the financial consequences there are around the LWAP/GWAP and the location losses. So we've actually shown it like that. And what you can actually see is where we pulled out the length, we've looked at every single 30-minute trading period where we are



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long and the price that we got when we are long. And we did the same thing where there's shortness. And you can see there, the length has improved year-on-year by [100] gigawatt hours and also the pricing that we've got on the length has improved year-on-year by [\$70] per megawatt hour. So collectively, that drives about \$45 million of increased EBITDAF.

So there are a few things that we can do to report that, and we did do. Dennis has talked about our flexible asset portfolio in the past (inaudible) able to leverage that. So we're in October we were able to extract more [gas] from the ground and produce thermal into higher pricing -- prices we saw in October. Actually, we were (inaudible) full year (inaudible) Wairakei in October, but we were able to safely defer that to allow us to continue producing, and I've already talked about what we did in C&I which obviously freed up volumes to go long in terms of merchant. So there were a few things that we could do to sort of influence (inaudible).

In terms of shortness, the good thing here as you can see, we are very rarely short and spot-exposed to the market in terms of Generation. And when we've gone into a period of more price volatility, you could see it's been knocked down even further, so we actually only have 1-gigawatt hour of spot exposure there to the grid. And that talks to the good risk management processes that we've got in place.

The LWAP/GWAP for a sort of balanced trading position that we've got going on there, the spread on that has increased a little bit. It's gone from [6.2%] to 6.7%. I'd put that down to the fact that we've had less North Island Generation, so less thermal. The impact to that spread increase normally wouldn't be that significant. But what's happened is because we've got higher prices in the (inaudible) at the moment when you apply that percentage spread to those higher prices, it actually comes up with a bigger location loss. So we've seen an increase in location loss of \$10 million.

So hopefully, that gives you a bit of insight, maybe a bit more than you've had in the past around the wholesale business and, well, that \$58 million EBITDAF improvement.

So next, on to the Customer business. So here, we've seen revenues down by \$2 million. EBITDAF is up by \$3 million. The revenue shortfall is we've seen slightly lower Customer numbers, which is obviously impacting our volumes. Although we have seen Customer numbers stabilize actually over the (inaudible) encouraging. But the reason why we can translate \$2 million revenue to \$3 million up in profit is about we're starting to see a bit of tariff pricing coming through, which is good. We've got \$2.20 per megawatt hour increase in tariffs there flowing through for electricity. And actually, that then widens when we get to a gross margin (inaudible), so we're up by \$3.10, and that's because we've seen higher network costs [almost as] higher, I think that's what we've seen in the past. We're in an unusual situation at the moment. And then we've doubled down on that because you're still seeing the (inaudible), the cost to serve, you can see there the green bar coming down from \$41 million to \$40 million. So you've got pricing, cost reduction across networks and then cost reduction and cost to serve driving that \$3 million.

In terms of our overall cost-reduction program across Contact, that's continuing to progress well. You can see there the downward momentum. On average, our other operating expenses is dropping by about (inaudible) every year. The headline number's down by [\$4 million]. But we've actually given you an underlying view of it because you'd expect our operating expenditures to drop as we've shed those 2 businesses and the associated costs with them. But the other thing that we've had in terms of a [noncost] is because of the outstanding financial performance this year, we're having to provide for increased incentive. If you back those 2 things out to get a like-for-like (inaudible) numbers, we're down by \$6 million year-on-year with 5% reduction, which is there or thereabouts of the 6% trend that we're seeing downwards. And just to give you a little insight into the sort of topics that are driving that number down, we're continuing to see savings around the ICT part of our business, more sort of applications to the cloud. We're continuing [to see our] bad debt levels reduce and we think some of that is linked to the new plan in place with the market, which make it easier for our customers to manage their cash flows and, therefore, less likely to get into difficulty. And we've got a leaner organization which, obviously, reduces the labor cost. So we've done all of those things. And actually, that \$6 million is net of some investments that we've also made around our brand that you'll be aware of but also around investing into digital. So we're on track to sort of hit our guidance for the year, which is about \$200 million to \$210 million.

In terms of cash flow. That's performed well. We're looking at this from the a total Contact perspective here, not just a continuing perspective. EBITDAF, up by \$55 million, but that's actually translating [into] operating free cash flow, which is up by \$62 million. So some really good cash conversion there. Trade working capital is positive, so we've managed our trade working capital down. Some of that is actually about the fact that we've net extracted gas from the ground and obviously when -- in the future, when we fill back up the storage facility, we'll have a cash outflow



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there that we do need to deal with. But we are, as I've talked about earlier, seeing better collection rates and lower bad debts which is playing into lower trade receivables.

We have seen tax up year-on-year, and that's actually about wash-ups from FY '17, wash-up that was paid in FY '18, with quite lower FY '18, wash-ups paid in FY '19, was a more normal level. That's driven the tax up by \$20 million. That's partly offset by the interest savings.

Stay-in-business CapEx was lower year-on-year. We are expecting it to ramp up a little bit in the second half of the year as we stay on track with those Customer and wholesale projects, which are going to deliver [EBITDAF] improvements into '20. And in terms of our overall stay-in-business CapEx, we are still forecasting that's going to be in line with the \$65 million to \$75 million I've previously given. And that's provided in each chart on the right-hand side that sort of reconciles to our historic \$75 million average expected CapEx down to \$65 million now, which reflects the fact of AGS and [others].

And just to finish off this slide, you can see the free cash flow there is up [\$500 million] exactly because that includes the proceeds on the disposals.

So we've had to a lot of (inaudible) cash in the first half of the year, a lot more than we normally have because of the proceeds and also because of the good operating free cash flow. Where has that gone? Obviously, we've paid a final dividend for FY '18 in September, but the rest of it has gone to book our balance sheet or strengthen our balance sheet, I would say. And that's (inaudible) on this slide you can see on the left, our net debt has reduced over \$0.5 billion over the trading period. And the impact that's having on our net-debt-to-EBITDAF ratio, it dropped from 3.1 to 2.2, and that's on an S&P-adjusted basis, so they bring AGS back onto the balance sheet. And the thoughts are that they will continue to do that, our first guess, sign up other long-term customers. If it wasn't on the balance sheet, it'd be about 1.9. Our average interest rate percentage has been dropping down neatly. You can see it did actually tick up. That's not because we've restructured and agreed to pay more interest. That's around mix. And with the proceeds coming in, we had to pay down our variable debt, because that's the ones that we're allowed to pay down. And that tends to be the lower interest rate than the fixed. We have (inaudible) and as we rejig our interest rate swaps, we'd expect to get that back in line over the next few months.

And I guess the last point [I want to make] is we've got a \$222 million retail bond that's due to mature in May. One of the things we're looking at, at the moment is the potential to refinance that with \$100 million retail bond. We haven't made any decisions on it, but I wanted to give you a heads up on that so that you won't be surprised if and when it happens. Some of the reasons why we may decide to refinance, is we have paid down a lot of debt recently, and we've got some cash outflows coming up in terms of paying the tax on the AGS disposal, plus, Dennis has already mentioned, the new dividend policy. So it might be prudent to see that to maintain liquidity. You can see that the tenor of our debt at the moment is 3.6 years in total. It would be nice to push that out a little bit. So if we were able to do a [retail bond] and get 1 over 5 years worth of tenor on that, that could take us up to about 4 years. I think the last thing, if (inaudible) it would be first -- we'd be the first corporate in New Zealand to issue a green retail bond, which obviously (inaudible) neatly with our decarbonization strategy and green credentials.

[I'll hand it back] to Dennis.

Dennis Barnes - Contact Energy Limited - CEO

Okay. (inaudible) 8 weeks and has clearly (inaudible) the numbers. I'll make a few forward-looking statements and then we'll go to questions. But there's only a few. I repeat the (inaudible) in the Customer and Wholesale businesses. We spent a lot of time in the last 3 years getting it really clear that these 2 businesses operate quite differently and have slightly different objectives focused on costs, I'd say.

Now the first thing people ask when you put a slide up which says near-term, medium-term is what do the dates mean and try working (inaudible) policy with the board and figuring out what average expected medium-term means. So I'll be a bit clearer on this. Stuff will probably have been able (inaudible) and medium-term is after August. I would say for the next few months, clearly contracting gas [is] important to us given the upcoming winter. Having said that, I do believe that once the (inaudible) planned outages (inaudible) and as I've mentioned with OMV's interest in making the most out of the business they've acquired from Shell, I think the gas availability and reliability will improve. We do have a very good (inaudible) to be able to manage any volatility. And obviously, we'll be looking at alternatives to gas such as storage or other contractual arrangements.

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We'll continue to deliver customer value. (inaudible) Electricity Price Review will be taking some of our time in the next few months. We believe we've created a product suite now which allows our customers to access fields reliably. The next proposition we will release and by imminently, I mean (inaudible). That's a Non-Prompt Payment Discount offer competitively priced. So 1 of the questions in the Electricity Price Review was around PPD. And I think that will be the last product that satisfies all of the questions that might be there from the Electricity Price Review in terms of customer products.

We'll continue to execute on the customer efficiency program. We will continue to go after those targets we described at the full year results. It (inaudible) level, I think made good progress and that's in FlexGas on the commercialization of gas storage. And you might be thinking that's so we can get it off the balance sheet. But actually, it's really important for security of supply and I think really important in a decarbonizing will to have secure, flexible gas supply and September, October, November, give us a -- gave us a taste of that. So we're getting capital-rich, fully commercialized (inaudible) with this expansion, which is continuing at pace with the expansion. We'll beat next year, I think is a really important short-term objective for us. (inaudible) we will continue to push our decarbonization strategy, which have multiple lenses, making sure that our thermal developments are the best developments for when the time is right. And they may be deployed either for the substitution of thermal generation and although the swaption contracts aren't up until 2022, you do have to start planning these things a couple of years out. You would (inaudible) we would (inaudible). But also, [having] real increase in demand, but I think that's going to come from large commercial (inaudible) and a lot of work and [foundering] with those.

Obviously, shareholder value is going to come from improved earnings; and improved earnings can come from capturing scale efficiencies, whether that's developing the low-risk, low-cost brownfield geothermal or leveraging our excellent customer systems and increasing customer advocacy into (inaudible); whether that's energy or adjacent products. Now (inaudible) conversation on the wholesale market and some of the options from New Zealand. We did (inaudible) Investor Day in November in the links provided. This is a results presentation. So we talked about results and we talked about what that means.

So in terms of guidance, nothing has really changed from August. We will continue to go after, and these are mid-point numbers, [\$205] million of OpEx this year, [\$190] million next year. \$60 million to \$65 million in CapEx.

After transactions have settled though, and we've looked to the balance sheet going forward, then the only real change is that we've added a line called cash interest, and that cash interest is probably slightly higher than you would've been thinking. So all within the rounding of the discussion last time.

Just to finalize the distribution policy in its full form. And I reiterate, our policy is to distribute 100% of operating free cash flow. (inaudible) balance sheet to write any variability in hydrology and CapEx. We will continue to target BBB, and we will continue to have a sustainable financial structure through multiple scenarios.

Dividend payments, as before, are expected to be split 40% in April, 60% in September to the extent we have imputation credits, then they'll be attached. But a little bit short of imputation credits for the next couple of years, so there probably will be a little bit of prepayment. [For it to be] easy for shareholders, we decided that the imputation level of 2/3, which we foreshadowed a couple of years ago, is what we've [modeled]; 100% of free cash flow, \$0.39, 2/3.

And with that, I'll go to questions. And we'll probably take investors in the room first and then we'll go to the phones.

QUESTIONS AND ANSWERS

Unidentified Analyst

A couple of questions, if I may. I guess, kicking off first of all with the dividend policy (inaudible). I seem to recall in the past you were talking about with the level of gearing dropping down and having some surplus capital there and maybe looking at (inaudible) in addition to the ordinary dividends. Is it done thinking? Are we still waiting for the Ahuroa gas storage deal to go through? What's the...

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Dennis Barnes - *Contact Energy Limited - CEO*

I think there's probably a couple of things to say. One is we (inaudible) when you're paying out 100% of free cash flow when you want to keep that stable, you have -- we've previously described hydro (inaudible) billion dollar risk. And we've got [free] CapEx variability and plant refurbishment for our drilling. So the first thing is you do want a buffer. So the board are very focused on maintaining stability in the dividend. And therefore, that drives a reasonable need for a buffer. If decarbonization does drive demand, (inaudible) and we can see thermal generation being substituted, then we would want to act on growth. But right now, there's nothing to say on that. And I think it's important for us to see AGS off the balance sheet before we were to commit in any way. Again, (inaudible) and see certainty of improved distributions, we'll go for it. And that's what today is (inaudible).

Unidentified Analyst

And the \$0.39 a share guidance. I'm assuming it takes into account the sort of the bumper hydro period you've just had in the first half.

Dennis Barnes - *Contact Energy Limited - CEO*

Yes, yes. We've normalized through to the -- I think in the full year results, we've said a normalized EBITDAF of 4 8, so we've normalized for that.

Unidentified Analyst

Yes, yes. Yes, okay. Next question I had was just around, I guess, the futures prices in '19, particularly strong. And I guess your commentary early on was that you see it very much being due to, I guess, the gas situation and then October and I think the period last year. Any sense when you see the gas situation normalizing? Do you see those -- that long-dated ASX curve dropping down again?

Dennis Barnes - *Contact Energy Limited - CEO*

If I would've predict it [at this time] perhaps it would be getting investment. So...

Unidentified Company Representative

If you take a step back, [work] in an underlying sense has changed. (inaudible) last September are largely still there. And there might be a little bit of costs in moving those P2 reserves to P1 contracted reserves. So you could see a little bit of a lift because the marginal fuel is increasing. Now carbon clearly, with consultation underway on the Emissions Trading Scheme, will be in those numbers. Given the volatility, you've not been able to discern how much is carbon. Technology costs are going the same way they've been going for 10 years. Wind has been getting cheaper. Geothermal, as we've described in November, has been getting cheaper. So if I go back to the fundamentals and take the noise of the short-term out, you would expect a reasonable (inaudible). But there might be a bit of an underlying support from gas and carbon.

Unidentified Analyst

And last question for me, I guess, is just on the contracting for gas and I guess, what sort of pricing you're seeing in the market at the moment? And obviously, you're confident of contracting gas again, but...



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Dennis Barnes - *Contact Energy Limited - CEO*

We'll see. I think our average price the past couple of years has been about \$5.80. You could see a lift north of that by maybe \$1. It's quite interesting, you look at what we bought on a (inaudible), which is in the operating statistics. So we bought (inaudible) petajoule on the spot market. And 1/2 of that's just quite a lot. We're only intending to buy 10 petajoule-ish. Half a petajoule's a reasonable quantity and I think the average (inaudible). So in a stressed situation, with an outage (inaudible). Yes, and there were some chunky electricity demand in January actually for air conditioning (inaudible). We're still being able to access the spot market at \$6.40. So I'm not expecting huge numbers. Nevill?

Nevill Gluyas - *First NZ Capital Limited, Research Division - Director of Equity Research*

Just a few. You mentioned the hit with price, sort of flatness. Are you expecting that to rise? And as far as given the conversation we've just had about ASX, in short-term, do you see upwards pressure on both C&I, but more importantly through retail?

Dennis Barnes - *Contact Energy Limited - CEO*

Well, I see (inaudible) we heralded an improvement in our retail business. We look at what Customer credits went on the balance sheet. They're flat. We've put \$3 million more of Customer credit (inaudible) line. So despite the most volatile [market] conditions we've seen in a long time, new entrant retailers are increasing their share. Electric Kiwi are adding 1,000 customers a month. And in essence, our wholesale -- our retail business is only improving its performance through cost efficiency. So an increasingly volatile wholesale market I don't think necessarily results in an increased (inaudible) of consumers. You'd have to ask the (inaudible) what their plans are, but you often see applications for customized price paths, billions of dollars of investments in networks which, at some point, will go (inaudible).

Nevill Gluyas - *First NZ Capital Limited, Research Division - Director of Equity Research*

Just continuing with the forward pricing theme, just in terms of substitution of thermal and potentially what other plasma do on top of -- you've been pretty clear on thinking about what you intend, which is on a builder view. You've got new-to-market lower contracts signed...

Dennis Barnes - *Contact Energy Limited - CEO*

And our clear substitution of thermal...

Nevill Gluyas - *First NZ Capital Limited, Research Division - Director of Equity Research*

Right. Do you expect others might build or that there's going to be any pressure in the market over the next 2 years just to start building out to do more production?

Dennis Barnes - *Contact Energy Limited - CEO*

There's probably a few things. One is you give a man a hammer and a large engineering company that likes to build large engineering things, so there is a little bit of excitement that comes in when prices are a bit higher. But demand has been flat for 10 years. Let's not forget demand has been flat for 10 years. So I think there will be a little bit of game going on as to who can capture an investable project. But -- so that's probably, number 1, the more subjective comments around it. I think there is a real opportunity to use the enhanced operation of the grid and water storage and new energy to take more gas and coal. And if you look at New Zealand's -- and obviously, Contact has been a massive contributor to this -- demand has been flat (inaudible) renewable proportion has gone from 65% to the mid- to high-80s. And we've all done good projects in maintaining (inaudible) the real opportunity that, that will happen. I think the puzzle is energy versus capacity. New renewables bring in energy but other than geothermal run at lower capacity factors than a gas plant. So energy versus capacity. So I could bring in megawatts of geothermal which would replace the energy that TCC -- for the 100 megawatts is 1/4 of the capacity of TCC, so you've got this energy-capacity puzzle to work through. But



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I think [with a] strengthened gas storage facility and water management, you could work your way through that. And then thirdly is getting customers to sign up to long-term low-carbon projects. And if you look globally, the last quarter I think we had -- I want to say quarter, but it could be 6 months -- in the world 13.5 gigawatts of new generation was committed to by corporate. And that's doubling every year. You've seen the likes of Sydney Airport in Australia commit to a wind farm with a firm end product. (inaudible) in my mind an opportunity with our C&I portfolio. And we're absolutely screening our C&I customers based on decarbonization opportunity.

Nevill Gluyas - *First NZ Capital Limited, Research Division - Director of Equity Research*

Great. And just 1 last question. We talked about the AGS cash callback. At the time of the sale, obviously, the tax payable was quite a large number in the balance sheet right now. I think we talked about \$48 million (inaudible) taxes. Is that still the proper number to call?

Dennis Barnes - *Contact Energy Limited - CEO*

\$45 million?

Dorian Kevin Thomas Devers - *Contact Energy Limited - CFO*

Yes, \$45 million.

Dennis Barnes - *Contact Energy Limited - CEO*

Because we only received \$190 million. And we're going to fight for the over \$10 million (inaudible) item.

Nevill Gluyas - *First NZ Capital Limited, Research Division - Director of Equity Research*

Is there anything else unusual in the \$70-odd million tax level there on the balance sheet?

Dorian Kevin Thomas Devers - *Contact Energy Limited - CFO*

The headlining of the deferred tax liabilities. So we've had a lot of projects there that seemed quite short, (inaudible) tech example, IT systems, the (inaudible) and the like. And obviously, as that unwinds, the tax payable rises if imputation credits (inaudible). There's going to be (inaudible).

Dennis Barnes - *Contact Energy Limited - CEO*

And the big 1 of recent history would have been SAP. SAP was on a 3-year tax (inaudible) versus 15 years on the balance sheet. Any more in the room before I go to investors on the phone? Then I'm coming back to media. Anyone on the phone?

Operator

(Operator Instructions) And we do have 1 question from Aaron Ibbotson with UBS.

Aaron Ibbotson - *UBS Investment Bank, Research Division - Director & Research Analyst*

I've got sort of 3 questions if I may, and apologies if some of this was mentioned. We had a bit of a bad line here. But my first question is -- and I guess you've touched on it with regards to the (inaudible) the C&I customers where you said you've pulled back a bit from that business, if I got



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you right. So I'm curious to understand -- let's assume that this wholesale price path continues and the long-dated ones stay around sort of \$90, \$95 level or something. Your C&I netback didn't really move at all between first half '18 and '19 when sort of wholesale prices up 50% and short-dated prices also up something like 50%; and long-dated, up. So I'm just trying to understand what dynamic we should expect there if the wholesale prices continue to remain high. Should I just go through my questions? Or do you want to answer that first?

Dennis Barnes - *Contact Energy Limited - CEO*

You go first. Go, just give your questions now.

Aaron Ibbotson - *UBS Investment Bank, Research Division - Director & Research Analyst*

Yes, my second -- yes, so secondly, I just -- you mentioned it a little bit but let's assume that you managed to reclassify your AGS debt in the next couple of years. Do I understand your communication correctly that we should assume that you feel that you have balance sheet flexibility to sort of come up with whatever solution you decide on Tauhara or otherwise without having to sort of reduce your dividend i.e., that you sort of have a bit of debt capacity to add growth CapEx now when you're not sort of accumulating if you're paying out 100%? That was my second question. And finally, you did touch on it when you came to gas going forward, but I wasn't 100% clear if you were referring to just sort of calendar year '19 or if you were talking about likely sort of longer-term. Do you think in the next few years, we would move up from this solid \$6 level up to a \$7 level? Or do you think it's just a little hump now with all the issues surrounding availability?

Dennis Barnes - *Contact Energy Limited - CEO*

Thanks, Aaron. So your first question, why didn't C&I move despite higher ASX prices? You're really only going to see it at \$1.26 per month. The average contract length for C&I is 26 months for a traditional contracting round. So November is (inaudible) contracting round for an early calendar year start. So if the price stays up, then you would expect to see that reflected in C&I netbacks over time, but it would take a full 26 months to flow through. In terms of fast-forward a couple of years of 100% payout, AGS is off the balance sheet and we're faced with (inaudible) of how to fund a (inaudible) tax cash return project. Then we would fully expect to be able to do that with debt, and we wouldn't need to disturb the dividend. But that's a high-class problem at some future date. But absolutely, the dividend policy has been set to allow that flexibility. The question on whether gas prices are up for the short- or medium-term. I think they've probably taken a little bit of a structural lift. The investment to go from knowing (inaudible) contracted reserves and the reliability that comes from that has a cost, and I expect some of that to be reflected in the gas price. What we've got to figure out from (inaudible) is how much is that. And it's quite possible that we may contract a few years and have some certainty of that over a few years. If you think probably in swaption replacement conversations early in the new year or later this year and we would be looking at the TCC major maintenance, it might be quite (inaudible) years of gas. And I think if we were to do that, then you might see a lower gas price because the producers have certainty. But I think whether there'll be a shift in gas prices, I don't think it's very much.

Aaron Ibbotson - *UBS Investment Bank, Research Division - Director & Research Analyst*

Okay. That's very clear. Can I just probe on my -- the answer to my first question on C&I a little bit? Because even allowing for sort of the \$1.26 movement, we have had a few months and we've obviously seen from the operating stats that it's not like it's new today. But I'll just take the opportunity to ask of you instead of terrorizing Matthew. But why are we not seeing somewhat of a movement then? So if you write the contract (inaudible) the contract today, what would you accept and why would you accept a price that is similar to the long-dated ASX, because you do have the variable volume so you're effectively giving them -- as far as I can tell you, you're giving away option for free so they're not paying anything for the security of price when they can vary the volume. I'm still a little bit surprised that we're not seeing a bit of an upwards movement on the C&I prices.



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Dennis Barnes - *Contact Energy Limited - CEO*

As far as -- there's a couple of things, Aaron. One is we haven't actually contracted for 6 months. Our winter support is gas side and we ain't got no gas. So this is a simple perspective on the risk management systems. Don't sell what you haven't got. But we haven't actually contracted during the 6 months, so you won't see much of a price uplift. But I think any offer you would see from us today would be higher than you would have seen before. So these customers are pretty [wise they] look through (inaudible) sort of [naive] on futures pricing. And if they have a view that they're going to come down, then they won't contract. So (inaudible) on whether this is a short-term effect and the market is a bit spooked because of gas reliability or it's actually a longer-term shift. Well, refer to my earlier comments, other than maybe a little bit of an uplift in gas and diesel and carbon, the fundamentals have not changed. So you would expect some flattening over time. So yes, our prices are higher for C&I today than they would've been 6 months ago, but we're not contracting very much so you're not seeing it in the numbers.

Operator

And we'll next go to Grant Swanepoel, Craigs Investment Partners.

Grant Swanepoel - *Craigs Investment Partners Limited, Research Division - Director & Head of Research*

Yes, a few questions. The first 1 is around controllable OpEx. You've got a go from \$223 million down to \$205 million. Do I have to add back the repayments -- the staff incentives? And then on staff incentives, what's driving that? Is that share price? Is it earnings performance? Is it cost out? And then just talking about the \$18 million drop in controllable OpEx this year, can you just run through that? Is it \$6 million due to the Ahuroa gas storage going out? Something for Rockgas? \$3 million for rebranding? Back on top of that, et cetera. Just give some sort of color on that one. And then linked to the controllable OpEx, I'm just concerned that your guidance type of number for free cash flow for FY '20 talking about EBITDAF \$480 million. Does that take into account the \$480 million of OpEx going from \$205 million down to \$190 million? So in effect, you're talking about a normalized one right now of around about \$465 million? Or are we going to be reading too much into that number? What's your assumption around gas cost for that number? Is there no retail pricing coming through to get to your \$480 million, et cetera? Can you please just clarify that \$480 million so we don't have any confusion out in the market? My next question is on the Ministerial Review. There seems to be a lot of talk about potentially doing away with a Non-Prompt Payment Discount -- or Prompt Payment Discounts. How many million is it that you guys recoup each year for people who don't pay promptly that could potentially hit your income statement if that does come through? And then my final question is on gas retailing. It seems to have had a bit of a downturn on that. Pricing's off a bit. Is that expected to continue? I'd be -- I'm surprised that actually your margins are declining on your gas retail market. That's it for me.

Dennis Barnes - *Contact Energy Limited - CEO*

So on (inaudible) of \$205 million target, that might be a little bit up. It could be \$207 million, \$208 million. FX is likely to come in lower so the combined target of \$270 million, \$275 million is intact. The bonus reversion to mean is cash flow driven, the 60% of corporate components of our bonus system is cash flow and 30% is EPS. So yes, it's the reversion to mean on bonuses. The drop from \$223 million to \$205 million this year, Rockgas coming out is \$8 million; AGS coming out is \$5 million. Add back \$3 million for staff incentives and we're looking at \$10 million total -- \$8 million, sorry, for operating improvements. And then I think if I go to the subsequent year where we've guided \$190 million, Rockgas, and another 1 of Ahuroa and then another \$9 million of operating improvements. And I've not mentioned it here but that steady-state of improving the digital nature of transforming our retail business to a technology business actually should see that \$190 million continue to reduce through '21 and '22. To the \$480 million question, Grant, why have we come out with \$480 million and not reflected any of the current operating conditions. I think there's a few things. 4 months does not make a trend. You have a little bit of a cost increase I expect from gas but tomorrow, all of that should be passed through. We've got a little bit of an improvement as a result of transmission costs. But I think it's just too early [to see] a significant -- or any increase in that \$480 million. But what we will do, when we see a systemic shift in that number and the subsequent cash flow number is we've (inaudible) level because the board are going to pay out a dividend unexpected. In terms of EPR, I think Prompt Payment Discount will be a feature of the solutions on the EPR. We -- and the figure you're looking for is how much PPD is foregone? So how many customers don't capture that PPD because of late payment? It's in the order of \$7 million or \$8 million. But there's an awful lot in that process. And if we were to (inaudible) a more -- a regulated PPD, where it's limited to a few percent, then I'm not sure you would see much of a (inaudible) in our earnings because we're just



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around that simpler products. I -- it's a long answer, but the customers who love their PPD (inaudible) when Meridian canceled their PPD, pleading with us not to get rid of PPD. Some customers like receiving a cost discount. Some customers like simple, No-Prompt Payment Discount Prices. Some people like to pay weekly, fortnightly in advance, and we've developed all of those options for customers. So I think actually taking PPD out of the mix is not necessarily that customer-centric, but I think it will be a feature of the EPR results. And gas retail is just mix, more small (inaudible) customers, (inaudible) residential customers who have a lower margin and a lower tariff. So that's the question -- residential margins are improving in gas.

Grant Swanepoel - *Craigs Investment Partners Limited, Research Division - Director & Head of Research*

Dennis, can you hear me? I just wanted to follow up on anything else we should be expecting on the Ministerial Review. And is something expected out this month?

Dennis Barnes - *Contact Energy Limited - CEO*

We're not expecting a solutions paper next week. We can't keep -- being speculated. That solutions paper, we understand, will be a series of 1-page potential solutions, pros and cons and then there will be consultation on those. I think we're going to see -- this is a speculation on my part. I think we'll see a lot of (inaudible) education and advocacy. We will see something on Prompt Payment Discount, and I think we may see something on market arrangements in Wholesale. But I think there will be useful quantification rather than wholesale change, but we got to wait and see. Anyone else on the phone?

Operator

And we'll next go to Stephen Hudson, Macquarie Securities.

Stephen Hudson - *Macquarie Research - Head of Research*

Most of mine have been asked and answered, but just going back to the 2020 EBITDAF guidance. Have you factored in anything for the HVDC Pole outage that's set for, I think, the first 3 months of the calendar year. And then just secondly on your unit carbon cost for FY '19. Can you give us a feel for what you've baked into your thinking, I suppose, for your EBITDAF for FY '19?

Dennis Barnes - *Contact Energy Limited - CEO*

Steve on your question on HVDC outage, the risk management systems have essentially -- I'll say forced -- forced is the wrong word (inaudible) and have some North Island contractual support in place, so we don't see any earnings impact of that outage. The carbon -- the calendar '20 cost -- as you know it's a calendar year, so it's always a bit tricky to figure out what year it is. I think fin year '19, we might be at \$18, \$19. Calendar year '20, we're at \$21. And then...

Stephen Hudson - *Macquarie Research - Head of Research*

Is that your (inaudible)?

Dennis Barnes - *Contact Energy Limited - CEO*

Yes, we went out after calendar (inaudible) and then we will have to buy more units. We're working on a few things which -- direct access to units which mean we won't be paying dollars or a proportion of the units, obviously, will be at that sort of level. We're going to see what the consultation does as well. For fin year '19, \$18, \$19; fin year -- calendar '20, \$21.



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Operator

And we'll take our next question from [Jason Lindsey], ACC.

Unidentified Analyst

Just 1 quick question regarding the valuation of your Generation trust payout this morning flagged a decline in value driven by a lower forward curve and looking at the annual report, though using just over \$90 megawatt hour (inaudible) by 2021, which I guess in hindsight seems a bit aggressive. I was wondering where you guys are at and if you're still comfortable with the assumptions?

Dennis Barnes - Contact Energy Limited - CEO

The board consider obviously a whole heap of impairment indicators in the half and the full year. I don't think we published this number, but I've got an impairment modeled at \$72 carryforward. So we take a pretty conservative view on our valuation model, which wouldn't -- I think if we hadn't \$90, yes, we might be facing the same question. But we take a pretty conservative view and we've got plenty of headroom. It was a bit of a surprise for us actually. But there you go. When you have issued a cleansing notice sort of bond issuance, then it makes you think, I suppose. Any more on the phone?

Operator

And there are no additional questions over the phone lines.

Dennis Barnes - Contact Energy Limited - CEO

So we'll go to, I guess, just dial (inaudible) and if you have any questions then we'll come back to (inaudible) online. We actually have 1 (inaudible). All good? So we've got questions online, Matthew?

Matthew Forbes

Yes, we just got 1 question online. It comes from Tim Hunter from the NBR. He asks, what options (inaudible) need to enable economic substitution of thermal generation with renewables given lack of demand growth doesn't support new renewable investment?

Dennis Barnes - Contact Energy Limited - CEO

I think it's very much the reduced or curtailed operation of either some of the Huntly unit or our Taranaki combined-cycle plant. The next big (inaudible) on that is 2022 with preparatory on that probably back end of this year or early next. And I can see a scenario where there is a bit of renewables, there's management of storage, both gas and water, and there's use of the greatly unconstrained grid. So I think there is an opportunity to take [a step] in renewable proportions (inaudible). What that looks like, it's probably a year away off though.

So any more questions in the room? And we're all done on the phones and online. So with that, thank you for your attendance, and no doubt I'll see all of you in the coming days.

Operator

And that does conclude today's conference call. We thank you all for joining us.



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