Announcement Teleconference

Thursday, 20 June 2019

Opening Remarks

Angus Guthrie

Director of Investor Relations, CLP Group

Good evening, ladies and gentlemen, and thank you for dialling into this briefing call for investment analysts regarding the announcement that we put out today. My name is Angus Guthrie and I am the Director of Investor Relations. On this call, we will have a short discussion of today's announcement delivered by Richard Lancaster, our CEO, and that will be followed by a short Q&A session.

The call is being overseen by a moderator and after we have finished this short introduction, she will invite questions and advise you how to submit them. We will answer as many questions as possible, but the questions will be restricted to those people who received an invitation for today's event. After this is closed, the session is being recorded; it will be posted on our website, hopefully within an hour or two, and a transcript will be available a little bit later on. My team and I will also be available to answer further questions after the call.

If that is all okay, Richard, I think we can proceed.

Announcement Briefing

Richard Lancaster

Chief Executive Officer, CLP Group

Introduction

Good evening everybody and thank you for joining this call.

You will clearly be aware that we lodged an announcement today with the Hong Kong Stock Exchange foreshadowing a requirement under our accounting standards for us to record an impairment of the goodwill on our retail business in Australia. Whilst there is still some work to do to finalise the calculations on the impairment, we know that it will be a sizeable impairment and expected to be in the range of HK$6 billion to HK$7 billion.

I would just like to state at the outset: this is a one-off. It is a non-cash item and does not have an immediate impact on the cash flow of the business or our business operations. But, as it does flow through the P&L, it is expected that we will be recording an unaudited consolidated loss on total earnings of the CLP Group for the first half of 2019.

Background, drivers and details

If you look at the goodwill in the Australian retail business, it essentially arose from acquisitions of large customer bases going back firstly in 2005, when the company was TRUenergy, and then again in 2011 with the acquisition of retail customers from the New South Wales government. As you are also I am sure aware, the accounting treatment of goodwill is such that it does not depreciate and it is not amortised. It basically stays at that value but is subject to impairment testing on a regular basis or, as in the case of this event, there were some events that required that impairment testing to be triggered.

The businesses that we acquired and the retail businesses that essentially form what is now EnergyAustralia were sound acquisitions and we have demonstrated the ability to compete effectively in what is an intensely competitive market environment. No impairment of goodwill has been necessary to date, so the amount of goodwill on our books is just as it was at the time of these acquisitions, which goes back in one case 14 years.

Looking forward, we do see that things have changed recently. Subsequent to the release of our quarterly statement, it was reported that new regulated electricity retail pricing will be introduced in Australia from 1 July 2019. There were two mechanisms: the Default Market Offer (DMO), which covers the states of New South Wales, Queensland and South Australia; and the Victorian default offer (VDO), which covers retail operations in Victoria. Both of these introduce a new reference price that effectively places a cap on retail prices at new, lower levels. In parallel with complying with these mandatory new pricing mechanisms, EnergyAustralia is also promoting simpler and lower-cost tariffs to our existing customers who are also on market offers. Consequently, with the introduction of these new measures that will come into effect on 1 July 2019, we do expect that our earnings before tax will reduce by around HK$240 million to HK$300 million in the second half of the year, and we do see that this would be an impact that would continue into the foreseeable future.

So, recognising that these changes will reduce our earnings over the long term, we did initiate a review of the carrying value of the goodwill associated with our retail business. The conclusion of this review is that an impairment of the goodwill in the range of HK$6 billion to HK$7 billion would be required. Given the size of this impairment, it was not appropriate for us to wait until the interim results, so we have made this announcement as soon as practicable.

We have also taken the opportunity in our announcement to update the market in relation to the performance of our broader Australian business during the first half of this year. Again, if you recall from our quarterly statement for the first quarter of 2019, not only was the retail market intensely competitive, but we had also experienced ongoing maintenance requirements at Yallourn and also some coal quality issues at Mt. Piper.

We have confirmed today that the unaudited consolidated operating earnings for EnergyAustralia for the first five months to 31 May were HK$731 million. That does represent a reduction compared to, for example, the HK$2.25 billion for the six months to 30 June last year in 2018. We have been working on resolving the issues at both Yallourn and Mt. Piper. We do not expect these issues to be repeated during the second half of the year at Yallourn and we are also undertaking efforts at Mt. Piper to improve the coal quality.

Notwithstanding this impairment, CLP remains a long-term investor in Australia. We do retain confidence in our ability to deliver long-term shareholder value through our EnergyAustralia business and, looking ahead, we are determined to work with this new market framework to deliver excellent customer service value to our customers, as well as maintaining an appropriate return for our shareholders.

Summary

So, in summary and before I give everybody the opportunity to ask questions, this is a requirement under accounting standards to impair longstanding goodwill. It has been triggered by a new regulated pricing regime that takes effect across all the Australian markets in which we operate on 1 July. These mechanisms will significantly impact the earnings contribution from our retail business going forward. The impairment itself is a one-off measure, it is non-cash, and does not of itself have an immediate impact on the cash flow of the business and the business operations.

With that, I would be happy to answer your questions.

Q&A

Dennis Ip (Daiwa Securities): Hello, good afternoon. I have three questions. Firstly, we have a goodwill of HK$15 billion for the Australia retail business and we only take HK$6 billion to HK$7 billion as an impairment. So do we have an idea of, in the event that the second half earnings – the retail part – has to reduce by maybe HK$300 million, are we still making a profit? Is there any risk of further impairments in the future?

Secondly is we have heard that the first five months operating earnings for Australia is HK$731 million. Can you break it down to wholesale and retail?

Finally, I understand that there is not much cash impact and the only impact probably will be the loss of the retail earnings happening in the future. I just want to make sure that our dividend policy would not be massively impacted by this retail business in EnergyAustralia. Thank you.

Richard Lancaster: Thank you for those questions, Dennis. As I said, we do have a requirement to look at the goodwill. We have done an analysis of that goodwill, which will see us impairing in the range of HK$6 billion to HK$7 billion. This is as a result of a clearly announced policy statement and policy platform both by the Victorian government and the federal government which have both been recently elected.

Looking at the regulatory landscape, this has been taken into account – we did report and forewarn about this in our quarterly statement – but there are no other policy objectives that would have a similar impact on the business that we can see for the foreseeable future. So, whilst we cannot make any conclusive statements about the value of the goodwill in the future, it is something that we do test each year on an annual basis and in the case of any new events, and at this stage we do not see any other regulatory events that would have to be taken into consideration.

To your second question on the total value, we have given an indication of an unaudited indication of the earnings for the first five months. We are not in a position to give a breakdown between the wholesale and the retail, so that represents the total earnings for the business as a whole.

Your third question was, I recall, on the dividend and the implications for the dividend. Clearly, we have looked at 2019 and if you look at the business as a whole we will be seeing a reduction in earnings from our Hong Kong business because of the lower permitted return. We also will see a reduction in India because of the sell-down to CDPQ. We had taken all of that into consideration, and yet we still had the confidence to increase our dividend at the end of first quarter, at 3%. Now, I cannot make any statements on behalf of the Board, but when you look at the materiality of this in the totality of our business, whilst the impairment is quite a large number, it is non-cash. I will leave it to you to judge, but in terms of the cash impact on our business, it is relatively small in the overall scheme of our business.

Wilson Ling (HSBC): Thank you very much for the presentation. Just one question, actually. For the past couple of years, CLP has been engaged in a value restoration strategy in Australia, which CLP has achieved by FY18. But due to this policy change in Australia, it could mean that we are taking a step back from that, meaning possibly a lower ROIC generated. I just want to ask about the strategy in Australia going forward – what are the things that CLP is going to do, maybe to keep on growing in the segment? Thank you.

Richard Lancaster: Thank you for the question. Our view of EnergyAustralia and the EnergyAustralia business has not changed because of this impairment. We do still see the value that we have in having a large customer base in Australia, the ability to operate in two main markets, in New South Wales and Victoria, where we have not only a strong retail business, but also a wholesale generating portfolio that is right sized for those retail businesses. So structurally, with a retail and wholesale business that provide that natural hedge, we do see this being a robust business model.

Our approach for more than three years now since 2015 is to get our business in the best possible shape – improve customer service, lower our costs, get our business operating as efficiently as we can and make sure we are doing everything we can to retain customers and develop our margin through improvements in efficiency and improvements in customer service. That remains our objective in Australia.

What we are seeing, though, is a period where wholesale prices have been steadily rising and staying at reasonably high levels, which has put an impact on the electricity bills that our customers pay. We recognise that when you are seeing prices rising and when your customers are having to pay more, we do have to do things to look at the long term value of our business. This is where we have taken steps over the past 12 months and we will be taking steps again to make sure that – particularly for the vulnerable customers in our business – where affordability is an issue, that we are not just ignoring that and that we are doing something about it. So revisiting our tariff plans, making them as simple as they can be for customers, is all part of and consistent with our value restoration strategy.

Going forward, a period of high prices is not going to be welcomed by customers or by regulators; we can see that and we understand that. High prices had been caused by a shortage of supply in a market which sees extreme weather putting pressure on electricity demand. High penetration of renewables coming into the system means there does need to be some investments made to stabilise prices to reduce some of the volatility. We are confident that those would be good investments and we are continuing to look at opportunities such as these that will help the business longer term.

So, whilst our strategy of value restoration is still key, the principles of that are essentially the principles of doing good business in a retail business. But we do also see a need for some investment over the coming years that will help the business in the longer term.

Angus Guthrie: Angus Guthrie here. We do still have Richard available for some few minutes, so I would hope that people can make use of this time. If not, then I will be available at later stages during the evening, but once again could I just encourage that, if there are any questions, please speak forward.

Angus Guthrie: Okay. Thank you, ladies and gentlemen. Again, you've got a few seconds just as I wrap up, but otherwise, we will close the call now. Janis and I and the team will be available during the course of the evening. I will be available for some time, but a bit intermittently due to a travel commitment that I have. But certainly, if you have any questions, please be in touch by email or send us a call and we will try and be as responsive as we can.

So, thank you very much again, I appreciate your time, and thank you, Richard.

Richard Lancaster: Thank you, everyone.

[END OF TRANSCRIPT]