20 June 2022

Briefing Call Transcript:

Profit Warning for the six months ending 30 June 2022 –

EnergyAustralia Earnings Update

Good morning, good afternoon and good evening, ladies and gentlemen. Welcome to the conference call. Our chairperson today is Miss Marissa Wong. Please, Miss Wong is taking your calls and I will standby for the Q&A. Thank you.

Marissa Wong

Thanks very much. Good evening everybody and thank you for dialling into this briefing call regarding the profit warning announcement that we just put out today. My name is Marissa Wong. I'm Director of Investor Relations. I am accompanied by Chief Financial Officer of CLP Holdings, Nicolas Tissot, and other members of the Investor Relations team.

We've got 30 minutes today, and we'll start with a briefing delivered by Nicolas, and that will be followed by a short Q&A session. Just some housekeeping notes, this call is being overseen by a moderator. She will invite questions and advise you on how to submit them after the briefing. Questions should be restricted to those who received an invitation today. Please limit your questions to two so that we can get through as many as possible, and thankful if you state your name and company affiliation at the beginning of your question. My team and I will be available to answer further questions after the call. And the session is also being recorded, and it will be posted on our website with a transcript to follow. With that, I will pass it to Nicolas for his opening statement.

Nicolas Tissot

Thank you Marissa. Good evening everybody. Thank you for joining this late call with a short notice. I'm happy to comment the announcement we have just issued after market close and answer the questions you may have in relation with this announcement.

Technically, our announcement is a profit warning as per the Hong Kong Stock Exchange rules. It is entirely related to the exceptional and prevailing market conditions in Australia and their impact on EnergyAustralia results. Before discussing the impact on EnergyAustralia and on CLP Group earnings, I would like to make reference to the broad market conditions we are facing in the Australian energy market.

You will recall that we reported the volatile and rising wholesale power prices for both bought and forward contracts in the Australian national electricity market in our quarterly statement for the first quarter of 2022. That was on the 16th of May. We also informed the market on the significant and favourable fair-value movements on forward energy contracts with a 2.5 billion Hong Kong dollars after-tax impact on earnings. In recent weeks, the Australian energy markets were faced with a bit of a perfect storm, driven by the confluence of the unavailability of some major coal-fired power stations, weather incidences, and high, if not very high, global commodity prices associated with the Russia–Ukraine conflict. As a result, prices in the national electricity market have further escalated to unprecedented and extreme levels in May. This has impacted further the spot market on a day-to-day basis and also driven forward contract prices higher. As a result of the persistent high prices in the market, and the concerns about the security and reliability of supply, reaching mid-June, the Australian energy market operator, known as AEMO, first introduced a 300 Australian dollars per megawatt hour price cap in most Australian states. And then, on the 15th of June, so just a few days ago, suspended the NEM spot market for the first time since its inception in 1998. We are facing really unprecedented event and we acknowledged and supported, EnergyAustralia authorities acknowledged and supported the decision of AEMO to temporarily close down the spot electricity market at that time, as the situation was posing challenges to the entire energy industry.

If I now turn to the impact on EnergyAustralia earnings, the first and most significant impact of these market conditions on EnergyAustralia earnings, as well as CLP Group earnings have been in relation to the use of the futures market to hedge our limited long position. As a gentailer, EnergyAustralia runs a broadly balanced portfolio with a limited long position in the generation side of the business. And we usually hedge that position ahead of time over a one- to two-year, one- to two-year period. As wholesale prices rise, our existing forward sold contracts signed in the past at lower prices, basically in 2020, 2021 for the contract in portfolio right now, they have become out of the money when marked to market against the high prices. And this is reflected in the fair-value movement as accounting unrealised losses.

Based on the Group's unaudited management accounts for the first five months ended 31st of May 2022, the unfavourable fair-value loss after tax for EnergyAustralia was approximately 7.2 billion Hong Kong dollars, which will impact the Group's operating earnings. This is recognised in the operating earnings line as per the accounting standards.

As I said before, these forward energy contracts are entered into by EnergyAustralia for economic hedging purposes, and they will provide benefits to the business in future periods when they unwind as the contracts expire, write off and then expire. As a reminder, according to accounting rules, they do not qualify for hedge accounting, and these fair-value losses are incorporated into our operating earnings. Furthermore, the unfavourable mark-to-market loss of 7.2 billion Hong Kong dollars relate to movements of forward energy contract positions at a particular point in time. That is, the loss is subject to change, depending on the forward prices prevailing in the market at the time of measurement. Obviously, the mark to market is going to continue to evolve on a daily basis until the final picture of the fair value is taken on the 30th of June 2022 to prepare our interim accounts to be announced on the 8th of August.

The second impact on energy coming from EnergyAustralia in recent weeks and months is in relation to the operational performance of the business. That's a more limited impact, but it's still a significant one. And we wanted to clarify to the market our situation in that respect. We communicated already now in our quarterly report that the financial performance of our energy segments in Australia was adversely affected by two things. First, relatively low prices received for electricity generated from the power stations based on hedging undertaken in previous years. And second, lower-than-expected generation from both Yallourn and Mount Piper, which has required EnergyAustralia to buy electricity at high prices from the spot market to settle contracts not covered by the power stations themselves.

I wanted to report today that we have continued to experience unplanned outages at Yallourn and Mount Piper, has also continued to be fuel constrained due to lower-than-expected coal deliveries from EnergyAustralia's supplier, the Springvale mine. And I'm happy to update that this week, three units out of four are running at Yallourn and that both Mount Piper units are back up. The impact during the first five months of the year was significant, and we reported in our announcement that for the five months ended 31st of May 2022, EnergyAustralia's contribution to the Group after-tax operating earnings, excluding the fair-value loss, was approximately 1.1 billion Hong Kong dollars lower than the same period for 2021. If you take into account the impact of the fair-value losses and the lower-than-expected operating performance of EnergyAustralia's generation assets, the consolidated operating earnings of the Group for the first five months ended 31st of May is a loss of approximately 3.7 billion Hong Kong dollars.

I want to mention that outside of Australia, all the other units of the Group are delivering at a level which is very similar to the same period last year. So really, the announcement today is entirely focused on the situation in Australia. The rest of the Group does not require any specific comments or announcements.

In summary, and before I give everybody the opportunity to ask questions, there remain challenging conditions in Australia, and we said that since the beginning of the year, and it continues to be so, and we are working around the clock with the EnergyAustralia teams for the market operators and our customers. Although there are some short-term challenges, we are unperturbed by the volatility, and we remain confident in our ability to deliver long-term shareholder value through our EnergyAustralia business. Thanks for your attention, and I'm happy to answer your questions.

Marissa Wong

Moderator, if you could open it up to the questions now, please?

Moderator

Thank you. Ladies and gentlemen, we are now open for questions. If you would like to register for a question, please press star one on your telephone. Thank you.

Our first question comes from Pierre Lau, with Citi. Please go ahead, Pierre. Thank you.

Question 1

Hello, good evening everyone. Thanks for your time today. My two questions on the company is that the first one is you mentioned in your 2021 results announcement saying that you are looking for a potential investor to take up some minority stake in your Australian business. Could you let us know whether there is any update in the last few months? And second question is, obviously, your Australian business seems to have profitability lower than previous expectations, and the question is whether you will further write down the assets there with more impairment losses. Thank you.

Nicolas Tissot

Starting with the first question, we completely confirm the direction of travel communicated at the beginning of the year. We are open to the idea of establishing a partnership in Australia. That could be at the level of a specific project or project that could be globally. But yes, we confirm our view that the best way to support the further development of the growth of

EnergyAustralia for us is to partner with a like-minded partner because we feel that in terms of capital required for participating to energy transition and in fact accelerating in Australia, we think that the best interest of CLP is to establish a partnership, so we are actively looking for partners, but there's not much more I can say about it. Work in progress.

About the write-down, it's obviously too early to comment about that one, and we have no particular announcement in that respect. I will just say that we will comply by the accounting standard. We will review any possible trigger events for the two CGUs, the two cash-generating units in Australia, and if needed, if we have a trigger, we will run a full impairment exercise, but this is too early to comment on that one, but obviously we will closely monitor the situation as required. Thank you for the questions, Pierre.

Moderator

Thank you. Our next question comes from Stephen Tsui with JP Morgan. Please go ahead. Thank you.

Question 2 – Stephen Tsui, JPM

Hi. Thank you for your time today. I have two questions. First is about the Australia business because you mentioned that the profit after tax was 1.1 billion lower than same period last year. So can you please give us a breakdown as to how much from retail and how much from wholesale? And then secondly, can you please give us an update on your several businesses in China, also India, and also other parts of the portfolio. Thank you.

Nicolas Tissot

So I guess you are talking about the state of the 1.1 billion Hong Kong dollars decrease of after-tax performance, underlying performance. I guess that's my understanding. We are going to look for a more detailed answer, but I would like to mention that this is not a results announcement, so we are not going to provide many details. I think our key purpose today was really to inform the market about key developments that we felt needed to be understood and shared with the market early in the process. But we will detail the first half performance in our results announcement early August. Having said that, basically, you heard where the shortfall in underlying earnings is coming from. It's coming from our energy segment. And it's relating to one key asset of the portfolio, Yallourn, to unplanned outages. So this part is really flowing the P&L of the energy segment in Australia. And the second source of shortfall is basically the issues with the coal supply of Mount Piper in a very challenging fossil fuel market. And this is true also internationally, as you are certainly aware, and this part is also flowing the P&L of our energy segment. So I would say, we see if we can provide you with further details, but the vast majority of the shortfall is coming from our energy segment in Australia.

Marissa Wong

Stephen, on that point, we don't give further guidance on specifics related to our current performance of retail versus wholesale, but you won't have to wait too long because on the 8th of August, we will have our interim results, and that's when we can communicate that split between wholesale and retail.

And the other part of the question, Nicolas.

Nicolas Tissot

So I'm happy to give a brief update on China and India, but basically, broadly speaking, the rest of the Group is behaving at a level and generating a level of earnings which is very similar to last year, at least until the end of May, which is the reference of our announcement. I think the key updates on China are relating to also the pressure coming from the international energy market on the coal supply, and it is inputting some significant pressure on our coal operations. But as a reminder, it is a quite small part of our portfolio in the Mainland, and the rest of the portfolio is first and foremost our nuclear operation. It's behaving very very well and according to plan. So, yes, there is some challenge, but limited to the coal-fired capacity. And all the rest of the portfolio, with Yangjiang performing really well, Daya Bay performing also well, and all the renewable portfolio broadly in line with last year. So that's the quick update on China.

And India is also delivering, I would say, at full pace based on the existing portfolio of renewables. Obviously, there is one coal asset in India, and it is exposed to the pressure coming from the situation, the tense situation on the coal market, but overall, the performance of India is also very similar to last year, broadly speaking.

Stephen, you didn't ask the question, but Hong Kong is doing well. I just remind you that the majority of our earnings.

Stephen Tsui, JPM

Thank you. If I can ask a quick follow-up question that our dividend policy should be independent of the fair-value changes, right? So we should assume a stable dividend.

Nicolas Tissot

I think we, I mean we have distributed a level of dividend over the results of 21, which was exactly similar to last year, so I think it is very important for the Group to continue with a consistent, stable way to serve the shareholders in terms of dividends, and there's no change in our approach to dividends, but then we always make a decision on dividends once we know the results of the year, and this is the final call of our Board to make the decision. But I think there's no change or no reason to change that I can report.

Stephen Tsui, JPM

Thank you.

Moderator

Thank you. Our next question comes from Evan Li with HSBC. Please go ahead. Thank you.

Question 3 – Evan Li, HSBC

Hi, it's Evan here. I have a couple of questions. First of all, you obviously mentioned about how wholesale prices have sort of been hedged. Can you give us some details of how your fuel prices have been controlled in 2022 should coal had been available? And also, the second question to that is how much of your historical costs since the original purchase of EnergyAustralia from Day 1, how much of that has been impaired?

Nicolas Tissot

So on the exposure to fuel prices as we already discussed in this call, I mean this is an international energy crisis with a lot of impacts coming from the conflict between Ukraine and

Russia, and there is international pressure on prices everywhere, including in Asia-Pacific, and that has put some pressure, and we are not entirely immune to this pressure. But we have some elements of protection. So I will first start with Australia because this is the topic of today. So in Australia, you know that our Yallourn power plant also comes with a mine, so we are sourcing the coal from our own mine, so we are entirely protected from international market prices. And in Mount Piper, we have a main supplier, with whom we have a multi-year contract, also at fixed price. So we have some element of protection here. And talking about gas, also, we have significant protection coming from multi-year contracts. So in Australia, we are pretty well protected. I think your question is also on the rest of the portfolio, but I would say that in most parts of our portfolio, we have limited exposure. Hong Kong is also put under some form of pressure, but first, with this Scheme of Control, the fuel costs are passed through to the Scheme of Control business. So we are passing this pressure to the end customers through the Fuel Clauce account. Also we have some protection coming from the fact that we have long-term partnerships with a limited number of suppliers, and our prices are not directly connected to international prices. So we are also, we actively manage the position through long-term sourcing. And I think the place where the exposure is the most direct to coal prices is actually in China with the caveat that in China, as you know, international prices are not directly applied, but they are somehow influenced by international prices. So we are using all the options available to buy our coal in China from suppliers who provide attractive prices. And we also benefit from all the measures taken by the government to stabilise coal prices. So I think you should not think globally of CLP as a group with a large, direct exposure to international volatile prices.

Marissa Wong

On your question on the impairment, the answer there is it's around 3 billion dollars Australian to date for EnergyAustralia.

Evan Li, HSBC

Got it. Got it. If I were to ask you another question, you know, sort of, you know, on the situation that we have, if the coal-fired units were available, should we expect, how much of those fair-value loss do you think would be encountered by the profit increases. I just want to try to understand, you know, your hedging strategy and position for this year and how the situation might be if those units had become available and under the current market, you know, how much would that be covered by the hedge?

Nicolas Tissot

I think in the first part, as we explained, including in the first quarter, we had the moments where we were kind of over-hedged, so we were not in a position to deliver the electricity associated with the hedges we had taken, so that has triggered some losses, which have nothing to do with the mark to market by the way. And I think it's because it was unplanned outages, but looking forward, if we are in a position to continue to return to, let's say, normal availability levels, we should no longer see this phenomenon because we are basically hedging based on expected availability. So I think with the situation and with the recent efforts to put back on the units of both Piper and Yallourn, we should certainly see less of what we've seen in the first half during the second half.

Evan Li, HSBC

Got it. Got it. Thank you. Thank you very much.

Marissa Wong

I think we're heading up against time, so probably room for one more question, please.

Moderator

Thank you. Our last question today comes from Teresa Yan with Morgan Stanley. Please go ahead, Teresa. Thank you.

Question 4 – Teresa Yan, Morgan Stanley

Hi, thank you Nicolas and Marissa for taking our questions. So first, we would like to ask, in July, alone, in a single month, because we noticed that the power generation of EA has improved meaningfully in that single month, so would EA make a positive contribution considering the rebound in the generation and the higher power tariff? And then also we would like to ask, in terms of the impairment risk, can you give us a breakdown of the goodwill between the energy business and the retail part? Thank you.

Nicolas Tissot

I'm not sure … what was your question on July month Teresa?

Teresa Yan, **Morgan Stanley**

Yes, in July, sorry, in June, my bad.

Nicolas Tissot

Yes, June. I was surprised you were talking about July.

Teresa Yan, Morgan Stanley

Sorry, yes. In June, can EA make a positive contribution, given the rebound in the generation and the higher power tariff?

Nicolas Tissot

Yes, I think the situation, if we keep on with the type of availability we have restored in the last few weeks or days, I think we can get to a better contribution, but keep in mind that we are still hedged for most of our generation, with prices coming from 2021, 2020, which were low prices. Our hedges are still way out of the money. So the improvement will come from being able to provide the electrons and be in a positive way of the hedges, but still the reference realised prices, we will get in June and also in the second half will be based on our hedging in the last few years.

On the impairment risk, I am afraid I cannot be very specific, but I think if I look at performance rebounding, on another question earlier today, I mean most of the shortfall is coming from the energy segment, so I think the pressure is more the energy segment. However, it is a good opportunity to mention that these very high prices are potentially creating opportunities for future earnings for EnergyAustralia, of the energy segment of EnergyAustralia. And as you can expect, I mean, any impairment test would be based on the future cash flows counted, and therefore, even if there is pressure in the short term, the evolution of prices we have seen in the market in the recent weeks is potentially paving the way for improved earnings in the longer run starting in 23 and 24 and even more 25, which are years where we are not yet fully hedged.

I think on the retail side, actually we are sort of benefiting from our position, so the, in terms of earnings, the level of margin is kind of positively impacted by the fact that we have hedged the sourcing of electricity of the gas, at a low price, so this is helping the margin, so I would not expect that there's a major challenge here in terms of impairment.

Teresa Yan, Morgan Stanley

Thank you.

Marissa Wong

Thank you everybody. I think I will put the call to an end. We really do thank you for your time and Nicolas for his time. My team and I will be here for any further questions that you might have. Just reach out to us by phone or by email. And have a good night. Thank you very much.

Nicolas Tissot

Thank you. Thank you Marissa, and I would say, I would conclude that most of what we discussed today, I hope we made it clear that this is really temporary in nature. So we have an effect, a very significant effect coming from the mark-to-market on our earnings for the first half. this is temporary in nature, and this is unrealised. Thank you, and thank you for your attention, and thanks again for connecting with us at very short notice.

Moderator

Thank you for your participation. Goodbye.

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