

Dong Energy A/S

Transcript :: Q2 2017 results ::

Operator:

Hello and welcome to today's DONG Energy's second call for 2017 results and Q&A call and throughout this all participants will be in listen only mode and afterwards there will be a question and answer session and just to remind you, this call is being recorded and today I am pleased to present CEO Henrik Poulsen. Please go ahead sir.

0.00.22

Henrik Poulsen

Thank you and good morning everyone. Welcome to this second quarter presentation. I am here in Copenhagen with our CFO, Marianne Wiinholt.

We are happy to report this morning that we have had a very strong second quarter. It has been characterised by excellent strategic progress across our portfolio and also strong financial and operational results.

Let me briefly recap some of the key developments if you turn to page 3 in the deck.

Our execution on the 2020 offshore wind build-out is very well on track. In May, we inaugurated Burbo Bank Extension in the UK and in June Gode Wind 1 & 2 in Germany. In May, we also reached another milestone in the UK as electricity was generated for the first time at Race Bank. This wind farm is expected to be fully commissioned by the first quarter next year. Walney Extension, Borkum Riffgrund 2 and Hornsea 1, as Marianne will come back to, are all well on track to take us to 6.7GW of installed capacity by 2020. The first turbines for Walney Extension left Belfast harbour actually earlier this week and we hope to have first power from Walney Extension later in Q3.

Looking further ahead, the 2,400 employees in Wind Power are working hard to meet our 11-12GW ambition by the end of 2025. So far we have, with the Borssele 1 & 2 wind farms secured 752MW of capacity. We have decided to construct 752MW of capacity rather than the originally anticipated 700MW simply to optimise the economics of the asset and to use the possibility of overplanting while the guaranteed capacity of the grid connection remains at 700MW. This has been part of further reinforcing and continuously improving the business case at Borssele. In April we were awarded three German projects which will add another 590MW to the post-2020 pipeline as over the coming year we mature them towards expected final investment decision in 2021 at the latest.

In the US, we have entered into a strategic partnership with Dominion Energy in Virginia regarding construction of 12MW off the coast of Virginia Beach. Being a pilot project, we will build the asset and Dominion Energy will be the sole owner. This partnership will provide us with valuable experience in constructing offshore wind in the US. Besides the construction of 12MW, the agreement, quite importantly, also gives us exclusive rights to pursue a strategic partnership with Dominion Energy about developing a commercial site with the capacity potential of up to 2,000MW.

A couple of important auctions will take place in the second half of 2017. We have the UK CfD auction with expected bid deadline next week where we participate to bid with our Hornsea 2 project. The outcome we expect will be announced on 11 September. In December, we will submit a bid for the first offshore wind project in Massachusetts together with our partner Eversource based on our Bay State Wind-project. The auction will cover a minimum of 400MW of capacity. A total of 5 bids in the range from 200 to 800MW can be submitted, but there is a mandatory requirement for a 400MW bid. In June we received an approval from the Federal Agency Bureau of Ocean Energy Management of our site assessment plan for Bay State Wind. This means that Bay State Wind is the first offshore wind project in the US that has been receiving such an approval of its site assessment plan by BOEM. This allows us to now install wind measurement equipment at the Bay State Wind site and continue progressing our site investigations.

In Taiwan, we are awaiting the approval of our environmental impact assessment which was submitted earlier this year and we expect a conclusion before the end of the year. If and when we receive this approval we have secured site exclusivity for the four projects in the Greater Changhua area. Next step will then be to obtain the establishment permit, at the latest at the end of 2019, and thereafter we will finalise the consenting procedures, sign the PPA and secure the feed-in-tariff, expectedly no later than 2020.

The next tender in the Netherlands, South Holland Coast, will expectedly take place during Q4 and it will follow a 2-step model where the Dutch authorities in round 1 will explore the possibility for zero subsidy bids. We have not yet received the full details of the tender process. Once we have them in hand we will assess the opportunity and decide whether to join the tender or not.

Looking into this year's farm downs, as announced earlier this week we have signed the farm down of Borkum Riffgrund 2. Our partner in this German wind farm is Global Infrastructure Partners whom we already know very well from our partnership at Gode Wind 1. We had originally not expected the Borkum Riffgrund 2 divestment to materialise this fast. But after the decision to pursue a transaction with GIP things move quickly as we essentially could build on our joint experience from Gode Wind 1. The process has been very efficient and we are happy to be able to execute the deal earlier than originally expected. We expect closing of the transaction before the end of the year and this earlier closing of course affects EBITDA for calendar year 2017. The SPA gain will now be realised in the second half of 2017 instead of 2018 being the reason for raising our 2017 operating profit outlook for the group from DKK 15-17bn to DKK 17-19bn.

The farm down of Walney Extension is progressing as planned and we continue to expect a completion later this year. We have decided to pursue and explore a farm down of Hornsea 1, first and foremost to manage our single asset risk exposure. Hornsea 1 will become the world's largest offshore wind farm and represents a significant value component in our portfolio. In a market where we can farm down while retaining the value of the project, we believe we are best off diversifying such as a single asset risk. This farm down is expected to take place in 2018 or 2019.

From the innovation side, I should maybe also mention that we are at the moment installing a battery system at the original Burbo Bank asset to deliver frequency response services to the grid. The addition of the 2MW battery system, set to be installed by the end of the year, will enhance the capability of the 90MW Burbo Bank wind farm. It will be able to support frequency regulation both up and down thereby helping the TSO maintain a stable grid. We see this as a further step into leveraging storage in combination with some of our existing assets to support efficient and stable green energy systems.

Since March, we have divested two non-core assets, most notably of course our upstream oil and gas division and more recently A2SEA, our offshore wind installation joint venture with Siemens. The off-stream oil and gas transaction is awaiting approval from the authorities in the UK, Norway, Greenland and Denmark. We expect to close both of these transactions during the third quarter. Our REnescience waste-to-energy plant in Northwich in the UK will be commissioned during the third quarter. The plant has essentially been finalised and we are now making final adjustments and running tests with the unsorted household waste supplied by the local waste management company. We continue to explore additional REnescience business opportunities in a number of markets. The most progressed pipeline opportunities are in the Netherlands, the UK and Malaysia and we hope for additional FIDs to follow during the course of 2018.

The conversions of our combined heat and power plants are progressing very well. So far, we have converted four out of seven plants with two additional conversions underway. Skærbæk will be fully commissioned in October this year and Asnæs is expected to be biomass converted by 2019. After these two conversions, only Esbjerg will not be biomass fired.

In June, Radius, our power distribution company, began the installation of smart meters at all customer sites after a successful pilot project at the end of last year and the beginning of this. By 2020, all our roughly 1 million power customers will have smart meters installed. This will be a strong platform for offering our customers better incentives to adapt their consumption to on-peak/off-peak price swings and also to the intermittent nature of renewable power generation. We see this as an additional important component of building efficient and integrated green energy systems.

Moving on to page 4, I just want to comment a bit on our capital structure. Building on our current investment plan and financial projections, we will within the next couple of years expectedly have excess financial headroom compared to our target rating of BBB+/Baa1, a target rating to which we remain highly committed.

As more wind farms come on stream and begin to generate earnings, we expect to reach a point where we generate more cash than required to fund the existing investment plan including the projects currently under construction as well as our targeted build-out beyond 2020. At the same time, we have over the past couple of years in particular also seen significant reductions in wind power construction costs as our strong focus on cost of energy has paid off. This also means that we see the CAPEX per MW constructed going materially down as we look beyond 2020. The reduced Wind Power CAPEX projection also adds to our financial headroom when we look 1-2 years into the future.

We will manage such financial headroom diligently to support the company's strategic development and shareholder value creation. We will on an ongoing basis seek to optimise our capital structure to safeguard our current ratings while also making sure that we do not have an inefficient and overly conservative balance sheet. We have noted recent comments from the market about our leverage levels potentially being on the conservative side. We manage our capital structure against our primary rating metric, FFO/adjusted net debt, and we expect our leverage to move up over the coming 1-2 years due to investments still surpassing our cash generation during this time frame.

We will continue to provide debt finance from our corporate balance sheet rather than building a complex structure of more expensive project financed debt. It should also be noted that through the farm downs we tap into a significant part of the value created by the project leverage taken on by our investment partners.

To repeat the point, we remain fully committed to our rating targets on the one hand and on the other hand we of course have no interest in being structurally underleveraged and we will continue to review our capital structure to maintain the right balance. Our cash flow will first and foremost be used to finance DONG Energy's existing growth and investment plan which is quite ambitious with annual gross investments running at DKK 15-20bn in recent years. And we will of course also stand by the dividend commitment made at the time of the IPO.

We see different uses for any future financial headroom beyond these existing investment and dividend commitments. If we identify value enhancing, green growth opportunities beyond the current investment plan they will be explored against tight strategic and financial criteria. This could include additional opportunities within offshore wind, which remains our core investment focus, as well as other renewable technologies and within our downstream business.

It is our vision to lead the transition to more sustainable energy systems and we will continue to pursue this vision. It has guided the transformation of DONG Energy over the past years, reinforced our competitiveness and financial robustness and it has created significant value for our shareholders. In the process, we have accumulated valuable capabilities and experiences and we will continue to deploy and enhance these capabilities to drive further profitable green growth. Offshore wind will by a wide margin remain our core growth engine and key investment focus but we will also look for opportunities to create value outside of offshore wind.

Any financial headroom will also eliminate the need for us to farm down in our offshore wind assets to recycle capital. After the farm down of Borkum Riffgrund 2 and the expected farm downs of Walney Extension and Hornsea 1, we will as such only consider farm downs as long as they are value creating in their own right and/or substantially support our asset and market risk diversification. We will in other words raise the bar on any future decisions to farm down.

Once we have safeguarded our ratings, honoured our existing dividend commitment, invested in value creating growth and potentially held back on future farm downs, should we still have additional financial headroom, it will be distributed to shareholders in a disciplined manner through increased annual dividends and/or share buybacks. Whether and when we might reach such a point is not something I want to speculate about today. We will probably be well into 2018 before we have the visibility needed to get more specific on this point.

On that note I am going to pass it on to Marianne.

0.17.19

Marianne Wiinholt

Also good morning from me. We saw very strong financial performance in Q2. Reported EBITDA was up by DKK 1.8bn corresponding to a 70% increase compared to Q2 2016.

The increase was driven by higher earnings in wind power. Earnings from wind farms in operation were up due to the ramp up of Gode Wind 1 & 2 and Burbo Bank Extension and a 9%-point improvement in wind energy content.

Earnings from construction contracts were up by DKK 1.6bn mainly due to a deferred gain on Race Bank of DKK 1.4bn as we now have fulfilled the conditions to obtain green certificates.

Net profit from continuing operations was DKK 2.5bn versus DKK 0.7bn last year. This increase is explained by higher EBITDA and lower net financial expenses which in Q2 2016 was negatively impacted by expenses in connection with the repurchase of bonds and earlier redemption of bank debt and interest rate swaps.

If we then turn to page 6, cash flows from operations amounted to DKK 193m excluding an outflow of DKK 2bn relating to early redemption of intra-group hedging contracts related to the oil and gas business. The strong EBITDA was partly offset by more funds tied up in working capital covering the high activity related to construction of offshore transmission assets, primarily Hornsea 1 and Walney Extension, the construction of Race Bank for partners and an increase in receivables from the sale of power.

Gross investments amounted to DKK 4.3bn. 90% of the total gross investments were in Wind Power, mainly Walney Extension, Race Bank, Hornsea 1 and Borkum Riffgrund 2. Bioenergy & Thermal Power accounted for DKK 200m of the gross investments covering biomass conversions of our CHP plants and the REnaissance waste treatment plant.

Our key credit metric, FFO/adjusted net debt, stood at 47% at the end of Q2, down from 81% at the end of last year. Return on capital employed for the last 12 months increased from 15% in the first half last year to 18% in the first half this year reflecting the strong performance and healthy returns of our portfolio.

If we then move on to our business units starting with Wind Power on slide 7, Wind Power delivered very strong results this quarter. We increased our power generation by 50% to 1.8 TWh driven by the ramp up of the production from the Burbo Bank Extension and Gode Wind 1 & 2 representing 258 and 582MW of installed capacity, respectively.

As I said earlier, the wind energy content was up by 9%-points compared to Q2 2016 and was 2%-points above a normal wind year.

The EBITDA was up by 85% corresponding to an increase of DKK 1.9bn compared to Q2 2016. The increase in earnings from Sites, O&M and PPAs was 48% and that was driven by the higher power generation. EBITDA from Construction contracts and divestment gains was up by DKK 1.6bn, primarily due to recognition of a deferred gain of DKK 1.4bn from the Race Bank farm down. EBITDA from other, including A2SEA, was down by DKK 200m due to higher project development costs and the A2SEA insurance compensation in Q2 2016.

Wind Power free cash flow decreased by DKK 2.9bn due to higher gross investments and more funds tied up in construction of offshore wind farms for partners and higher working capital relating to construction of offshore transmission assets, mainly Walney Extension and Hornsea 1.

Wind Power's return on capital employed for the last 12 months improved to 17% from 11% in Q2 last year and was also driven by the gain from the 50% farm down of Race Bank in December 2016.

If we then turn to slide no. 8, to meet your request for more transparency into the timing of our farm down gains we will share our best estimates with you. In this slide, first we give you the expected distribution of the total farm down gain into SPA gains which are normally recognised at closing of the transaction and construction gains referred to as CA gains which are recognised over the construction period. We do not give the exact split but we show the CA gain in 25% ranges. And then the SPA gain is still residual.

Secondly, we are showing you the estimated distribution of the CA gains over time shown in more narrow ranges. It is important to emphasise that these represent best estimates and the actual construction progress can deviate from this estimate even when the project is completed within budget. It is also worth noting that Race Bank is the only transaction where part of the SPA gain has been deferred linked to a specific milestone. We hope you find this additional information useful.

Our 2020 build-up plan on slide 9 shows strong progress on all projects. With the inauguration of Burbo Bank Extension and Gode Wind 1 & 2, we have today installed 3.8GW and we expect to install an additional 2.9GW by 2020.

Post-2020, Borssele 1 & 2 are adding 752MW to our installed capacity. We have with the turbine agreements locked in most of the CAPEX and since we submitted our bid back at the end of April 2016, our investment case has continued to improve.

We were awarded three German offshore wind projects with a total capacity of 590MW in April. As these three projects are still subject to final investment decision, we have not included them in this slide of the build-out plan.

If we then move on to Bioenergy & Thermal Power on slide 10. The EBITDA decreased by DKK 100m due to negative power generation spreads. Free cash flow was negatively impacted by the lower EBITDA and lower pre-payments from heat customers relating to the biomass conversions compared to a year ago. We still expect BTP to be cash-flow positive for 2018 as income from heat production will further increase.

Let us then turn to page 11 and Distribution & Customer Solutions. Here the underlying EBITDA was up by DKK 100m due to a strong performance in Markets. The free cash flow generation in this year was down by DKK 2.4bn mainly due to the negative effect from intra-group settlement of the unwound hedges of DKK 2bn between DCS and O&G. The settlement of the hedges does not have any effect on the Group's net debt as it is fully offset in discontinued operations. Also higher trade receivables related to power sales contributed to the lower free cash flow. Adjusted return on capital employed (ROCE) came in at 41% and is significantly impacted by one-off payments received from the long-term gas contract renegotiations. Excluding these one-offs, return on capital employed (ROCE) was 23%.

Please note the earnings in these years are heavily front-end loaded. Earnings from distribution are typically significantly higher in the first half as tariffs are set to the high end to ensure that the full income cap is utilised even in case of mild weather etc. in the second half of the year. Earnings in markets have been positively impacted by two effects. In Market Trading, earnings have been very high in the first half year due to unwinding of the O&G hedges which have contributed with high volumes and trading spreads. Secondly, in the gas portfolio there is a significant positive hedging effect which will come back with negative numbers in the second half. This relates to hedging of expected purchases made in the summer, which is Q3, to be sold in the winter, Q1, to benefit from summer/winter spreads. This spread is locked in through hedges made 2-3 years in advance. The price development since the gas purchase and hedging - they have resulted in a significant hedging gain in the first half year and will give a negative effect in the second half year.

If we then turn to slide 12, in the Annual Report for 2016 the upstream oil and gas business was presented as assets held for sale and discontinued operations. In May we announced an agreement to divest our oil and gas business to INEOS and we expect to close the transaction in Q3 2017.

Production of oil and gas declined by 24% Y/Y due to lower production in Norway following the divestment of Trym, Ula, Tambar and Oselvar in 2016. We also faced lower production in Denmark from the mature fields Siri and Syd Arne.

EBITDA was up by DKK 900m due to the recognition of ineffective hedges which gave an effect of DKK 1bn. The settlement with the supplier consortium regarding the Hejre EPC contract of DKK 300m and higher prices. These positives were partly offset by the lower production. The net profit was up by DKK 2bn due to higher EBITDA and the fact that fixed assets are no longer depreciated due to the asset classification.

Impairment losses were an income of DKK 700m due to the reversal of provisions following the Hejre EPC contract settlement. Free cash flow was up by DKK 2.8bn mainly due to the earlier mentioned DKK 2bn intra-group settlement of unwound hedges between O&G and DCS. The higher EBITDA and no gross investments also affected free cash flow positively.

Please note that DONG Energy keeps all cash flow from O&G until 30 June.

Then, finally we move on to slide 13. As Henrik mentioned in the beginning of the presentation, we have, due to the earlier than expected farm down of Borkum Riffgrund 2, upgraded our outlook for the Group's EBITDA Monday this week. Our guidance for the Group's full-year EBITDA is now DKK 17-19bn, upgraded from DKK 15-17bn. Wind Power's EBITDA for 2017 is now expected to be 'significantly higher' than EBITDA for 2016 and not only 'higher'. We still expect to complete the farm down of the Walney Extension in 2017.

Our guidance for Distribution & Customer Solutions' underlying EBITDA is now upgraded to 'lower' from 'significantly lower'. We maintain our expected gross investment range of DKK 18-20bn for 2017.

And this concludes our presentation and we are now happy to answer your questions. Operator please.

0.31.46

Operator

Thank you. Ladies and gentlemen, if you have not already, could you please press 0 and then 1 on your phone keypad now in order to enter the queue and then after I announce you just ask that question. And if you find that question has been answered before it is your turn to speak, just press 0 and then 2 to cancel. And the first question is over to Jenny Ping at Citi Group. Please do go ahead, your line is open.

0.32.19

Jenny Ping

Hi, good morning, it is Jenny from Citi here. I have got three questions. Firstly, just on the timing of the Borkum 2 disposal. Can you say why that progressed at such a fast rate compared to something like the Walney Extension which you have obviously been working on for quite a long time and you had originally at the time of the Capital Markets Day guided towards the Borkum 1 into 2018 and secondly on Hornsea 1

farm down, will you still stick to the 50% for this asset or could it actually be lower farm down of advantage given the need for cash may not be as strong as before and then just lastly on CAPEX outside of the offshore wind base. At your Capital Markets Day, you talked quite a bit about the REnaissance projects, the 10 sites, potentially in Malaysia, the Netherlands and Denmark as expansion. Can you give us an update to that? But also comment on what else you have in mind for CAPEX outside of offshore wind. Thank you.

0.33.37

Henrik Poulsen

Thank you, Jenny. Let me try to answer the questions. When it comes to Riffgrund 2, the simple explanation for the farm down materialising faster than anticipated is simply that once we had narrowed in on Global Infrastructure Partners as our counterparty things moved really fast because in many ways this farm down transaction resembles the Gode Wind 1 transaction that we did recently with Global Infrastructure Partners and as such we had a pretty strong starting point for quickly finalising another transaction with them and therefore it was a relatively swift process. I have to say it is a farm down that we are very happy about – very happy about the partnership with GIP, but we also believe it was a very strong outcome for DONG Energy so all in all we are quite pleased that it was moved forward but even more pleased with the outcome of the transaction. On Hornsea 1, we have not decided on the exact capacity to be farmed down. It will obviously not go beyond the 50%. It could be 50% but we have not decided on the exact size of the farm down just yet. It is still very early days.

On CAPEX, when it comes to REnaissance we are obviously working hard to now bring Northwich onstream and really learn from that first full-scale plant. We are working on pipeline opportunities, as I mentioned, in the UK and there we are looking at a pipeline of a few projects. We are also working with a partner in Malaysia right now to mature projects towards a potential FID during next year and we also progressed on a pipeline opportunity in the Netherlands, those are the most sort of specific opportunities currently being worked on. So I would say the general master plan that we shared with you back at the Capital Markets Day, I would say that still stands.

When it comes to CAPEX beyond the existing investment plan, it is important to emphasise that if we can find additional value creating opportunities inside the offshore wind sector, we would certainly take a close look at them. I can't say that we have anything specific in mind but we obviously on an on-going basis scan the global offshore wind market for any opportunity. We also have over the past 5-6-7 years built a pretty strong track record when it comes to identifying renewable project opportunities, maturing them, designing the assets, building the assets and operating the assets, not only in offshore wind but also in the area of biomass and now also waste-to-energy. So we are looking in the area of bioenergy as one example, we are, as I also referred to, also looking into storage as another technology where we see an opportunity to augment some of our existing assets also driving further value, all of this being simply a matter of extracting more value from our vision of building integrated green energy systems. So I would rather not start speculating about specific opportunities at this point in time but just saying that we will pursue the value-creating growth opportunities that we can identify. But we are also going to be very disciplined when it comes to the strategic rationale for these opportunities and of course not least the financial value creation of the opportunities.

0.37.50

Operator

Okay, we now go over to the line of Jørgen Bruaset of Nordea Markets. Please go ahead.

0.37.59

Jørgen Bruaset

Thank you for taking my question. A couple of questions from my side just to stay on the topic of the renewable technologies. Just to clarify, are you saying that you will probably favour technologies which in some way is linked to the operations within either offshore wind or bioenergy or are you looking at sort of complementary production technologies such as, just for an example, solar PV and if so is it fair to assume that you will favour technologies in the more complex and less mature sort of phase in the renewable space? That is the first question.

0.38.44

Henrik Poulsen

Thank you, Jørgen. It would be premature to start speculating on the specific opportunities. What I can say is that any investment that we would pursue would clearly have to build on the capabilities that we have built. We have distinct capabilities and a strong track record in a number of areas and our ability to continue to leverage and expand those capabilities, to drive competitiveness, to drive a shareholder value that is our starting point. But to get more specific than that at this point in time, as I said, that would be premature.

0.39.28

Operator

Okay, we now go over to Deepa Venkateswaran of Bernstein. Please go ahead, your line is open.

0.39.39

Thank you. That is Deepa Venkateswaran from Bernstein. I have three questions. Firstly, I really appreciate the transparency on the farm down disclosure, I think that is really helpful and also your thoughts on the capital structure. So the first question I wanted to ask you is when you are looking at the long-term capital structure of the company, given that it is largely an offshore wind portfolio and you know we see quite a lot of significant leverage being employed in projects, whether they are using project finance or otherwise, even touching 75%. So when you look at the capital structure of the company, what sort of gearing do you envisage? And I know you talk about FFO/net debt but if you could just translate that into is that a 40% gearing, 50% gearing, long-term what do you assume when you are doing your WACC?

The second question I had was on Taiwan. In terms of the EIA permit if you get that by the end of this year is it then pretty much a done deal that you would be able to capitalise on the feed-in-tariff or will there be a selection of some sort by the authorities there, given that there is quite a strong interest in any projects in Taiwan? Yeah, I think those are my questions. Thank you.

0.40.57

Henrik Poulsen

Alright, thank you very much, Deepa. On the gearing we clearly want to have a healthy balance sheet and we want to sustain our ratings so we are very focused on FFO/net debt for the simple reason that it is the leading credit metric for the company and it is what we look at, it is what we problem solve against when we optimise our capital structure so we have relatively little focus inside the company and therefore we are also not speaking a lot about it on the outside when it comes to net debt/EBITDA metrics so I cannot give you a direct translation but obviously there is a correlation between FFO/net debt, net debt/EBITDA leverage targets but I cannot give you a target, we simply don't operate a target as we are very focused on this being a matter of sustaining ratings while not building too conservative a balance sheet.

When it comes to Taiwan, we would, as I mentioned, expect the EIAs to be hopefully approved by the end or before the end of the year and once approved they would essentially secure site exclusivity and from there we would move into obtaining establishment permits and from there we essentially move into a PPA and consenting process and ultimately that leads to the feed-in-tariff being locked in. So we hope all of that to be settled no later than in 2020. So there is still a process with different steps ahead of us here but we are making very good progress and we feel at home in Taiwan by now, we have a strong team out there and we are progressing the investigations of the sites fully as planned, so so far we are actually or we remain very positive on the opportunity in Taiwan.

0.43.02

Deepa Venkateswaran

Thank you.

0.43.06

Operator

We are now over to the line of Kristian Johansen at Danske Bank. Please go ahead, your line is open.

0.43.13

Kristian Johansen

Thank you so three questions from me. First question is regarding Race Bank and Walney where you say you expect first power here into second half. How should we think about the contribution on production from these two wind farms in the second half? Second question is regarding the Walney Extension farm-down. Can you just remind us what proportion of the expected proceeds you have hedged and at what level

you hedge the GBP? And then third question regarding the sale of the transmission assets for Race Bank, Walney and Hornsea, when do you expect that to take place?

0.43.55

Marianne Wiinholt

On the Race Bank and Walney Extension contribution for 2017 that will be limited. And on the hedging of Walney Extension we have fully hedged the expected proceeds. And Henrik you will answer the third one.

0.44.14

Henrik Poulsen

What was the third question, Kristian? Could you just repeat the last question for me?

0.44.19

Kristian Johansen

Sure. So you are going to sell the transmission assets for Race Bank, Walney and Hornsea, which will obviously impact your net working capital once that happens. Can you just help us on the timing of those three divestments?

0.44.31

Marianne Wiinholt

Oh yes, sorry I didn't get the question. Yes, Race Bank, this is expectations and they can sometimes be delayed but our best estimate is that Race Bank is in 2018, Walney Extension in 2019 and Hornsea in 2020.

0.44.49

Kristian Johansen

Okay and then just going back to the hedge on the Walney, the level you have hedged the GBP at, can you give us a specific level?

0.45.00

Marianne Wiinholt

Significantly higher than the current level, so I only give these averages that you have already received, I cannot give it per project but it is in the same range as the average we have given you before.

0.45.15

Kristian Johansen

Excellent, thank you.

0.45.16

Operator

We are now over to the line of Mark Freshney at Credit Suisse. Please go ahead.

0.45.20

Mark Freshney

Good morning. Can I ask three questions, please? Firstly on the capital investment cost, the guidance given at the time of the IPO a year ago was DKK 22-24m per MW. Clearly you are running to schedule. It looks like you are not eating into any contingency. Is there any scope for the existing pipeline to result in lower CAPEX costs? Secondly, when you won the sale process for farm down assets, have you sensed that customers or potential clients are becoming concerned on pricing in the risk premium for Brexit and particularly the aftermath? Because it is interesting that we haven't really seen any risk premium priced into transactions in the space recently. And thirdly, on the DKK 1.9bn hedges that were put on the Oil & Gas or the value of the hedges on the Oil & Gas production business that you retained, did you close out or lock in those hedges at 1.9bn or is what you are saying that you have actually let those hedges run and they have become even more in the money? If you could just clarify those points, thank you.

0.46.42

Henrik Poulsen

Thank you, Mark. I will try and answer the first two questions and Marianne will comment on the last one. When it comes to the CAPEX guidance that we put out at the IPO and repeated at the CMD of DKK 22-24m per MW constructed, we would maintain that guidance for the pre-2020 build-out plan so that is up until and including Hornsea 1, we still expect to be sort of in that range. We obviously will see the CAPEX per MW going down materially over time due to all of the COE progress that we are making and when you look sort of beyond that current build-out plan beyond Hornsea 1 you should expect CAPEX per MW constructed to start going down and also going down materially. When it comes to farm downs we have not detected any demand for a risk premium related to Brexit when it comes to our UK farm downs. So far that is not something we have encountered.

0.47.57

Marianne Wiinholt

Yes and then on the third question, the hedges from O&G it is 2bn and we have closed down all the hedges so it is completely in a way out all the way.

0.48.13

Operator

Okay we are now over to the line of Casper Blom at ABG. Please go ahead.

0.48.19

Casper Blom

Thanks a lot, just a couple of clarifying questions regarding Oil & Gas and the discontinuing of that. Marianne, you referred to this strong cash flow in the Oil & Gas business but also that it is being a bit offset by other parts of the Group. Can you just sort of clarify the 2.5bn of net profit that you are booking for the Oil & Gas here in the quarter? How much of that is sort of really becoming cash flow and what value do we have in the Q2 operation from Oil & Gas? And then secondly, how should we think about the reporting of Oil & Gas in the third quarter? I suppose it will sort of disappear from discontinued operations but you also talked about a gain back when you announced the deal. How will that be booked in Q3? Thank you.

0.49.17

Marianne Wiinholt

Yes, from the Oil & Gas it is a mix of something that will have positive cash flow effect, of course the EBITDA in a way runs through and gives positive cash flow effect. The higher EPC contract settlement that we made, that is, most of it is a reversal of a previous provision so that will not have cash flow effect so it is a mixture. On the gain, which we expect to see in the books in Q3, that will be a gain we will see below the EBITDA line from profit from sale of enterprises.

0.50.03

Casper Blom

Okay, just coming back on the cash flow. If you were sort of to net out the, how can you say it, intra-group effects between O&G and DCS then what would the cash flow be?

0.50.16

Marianne Wiinholt

You should deduct the 2bn. That is the positive effect from these unwound hedges so if you look at that free cash flow we had in Q2 of 2.6bn, 2bn of it is the unwound hedges and the rest is operating cash flow, you can say, or normal free cash flow.

0.50.37

Casper Blom

That is very clear. Thanks a lot, Marianne.

0.50.41

Operator

We are now over to the line of John Musk at RBC. Please go ahead, your line is open.

0.50.47

John Musk

Yeah, morning everyone, two questions from me as well. Firstly I am coming back on the CAPEX post-2020. Is there any guidance you can give on the materiality of the reduction that you are expecting, I mean can we talk about 30%, 50%, what sort of level? And also within that, how does that potentially differ by geography in Europe and then the new markets of, say, Taiwan and the US. Are there material differences by geography? And then secondly, back to shareholder returns as you look to potentially increase those in 1-2 years, as you said, have you had any discussions with the government as your major shareholder as to whether they have any preferences between buybacks and enhanced dividends?

0.51.43

Henrik Poulsen

Thank you, I mean when it comes to the CAPEX guidance beyond 2020, we would rather not start issuing sort of a new rule of thumb actually for the very reason that you also refer to, which is that we will see significant differences from one project to the other and one geography to the other. Generally speaking, we will certainly be going below the level of 22-24, in some markets we will go significantly below and some projects will be stronger than others, that is the nature of the business, so to speak. When it comes to Taiwan and the US, we would at least during the first projects we would expect a small CAPEX premium for the simple reason that we would expect to initially source some of the components from Europe so at least for the early stage of the development of those new markets we should expect CAPEX per MW to be slightly higher than what we experience in Europe. So I would rather not get more specific and start giving percentages or specific numbers but we are looking at a material step-down in CAPEX per MW beyond 2020. When it comes to shareholder returns it is not a conversation that we have had in any detail with the Danish state just yet. We have seen market comments on our capital structure recently and we have seen a demand also from investors' side for us to come forward on the topic and that is why we have decided to do so today but I would remind everyone that the excess financial headroom that we are looking at will not materialise until probably towards the end of 2018 and into 2019 and therefore it is not a discussion that we need to have just yet. So I think it is something that we can look forward to but let's cross the bridge when we get there and we will certainly also involve our majority owner in due time.

0.53.50

John Musk

Okay, thank you.

0.53.52

Operator

We are now over to the line of Timothy Ho at Morgan Stanley. Please go ahead.

0.53.56

Timothy Ho

Hi, good morning, three questions from me and they are all focused on gross investments and net debt. The first one is can you provide any colour on how much capital is currently tied up in offshore wind working capital that will automatically come back to you, i.e. those OFTO assets as well as how much more there is to spend? And secondly, is it possible to help us understand how you expect net debt to evolve through to the end of this year, given we have material moving parts going in both directions? And thirdly on gross investments, is it fair to expect this to peak in 2018 on current plans, given you will be spending on Borkum, Hornsea, Borssele and Walney, then? Thank you very much.

0.54.35

Henrik Poulsen

Maybe I can just start with the last point and then Marianne will take over. On the gross investment peaking side I mean we would rather not start implicitly guiding beyond the current year, I think that would be a little bit sort of imprudent of us but no doubt we are currently spending broadly on a significant range of construction projects and that will continue into 2018 but I would rather not start implicitly guiding on our longer-term CAPEX expectations. If we go back to the gross investments and the net debt tied up in Wind Power, I will just have Marianne take over on that point.

0.55.21

Marianne Wiinholt

Yes, if you look at what we tie up in work in progress in the 30 June balance sheet it is 7.7bn but you should also take into account that we will with the very large projects we are currently constructing, Hornsea 1 and Walney Extension, we will add to this and then when we sell the OFTOs we will get it back over 2018, 2019 and 2020. But for now it is 7.7.

0.56.00

Operator

Okay we now go to the line of Sam Arie at UBS. Please go ahead, your line is open.

0.56.03

Sam Arie

Hello, thank you, good morning. I have three questions and the first one is hopefully very simple on this year's guidance upgrade. So if I understand this correctly, you are raising the range by 2bn to reflect the farm down announced earlier this week so the implication there is no change in the guidance range for I suppose the underlying business excluding that farm down but then there were some positives that we talked about today and I think you talked about this year being a little bit stronger than expected before so will it be reasonable to think we are now heading for the upper end of your range for this year? And then my second question is a bit on the longer horizon and just coming back to your target for capacity additions then I think you have talked about 11-12GW in total for the wind business by 2025, I think some might say that is still quite a conservative objective and as I read from the balance sheet discussion that it is not your ability to finance projects that would be the constraint at this stage so can you just talk about what would be the constraint you see on actually adding more than a GW per annum in the 2020s and if it is possible there is some upside there. And then my third one is just if possible if you could give us any sort of sense of your latest thinking on likely returns in the 2020s and if you are not comfortable talking about that in Europe then perhaps you could talk about the returns you might get in Taiwan since that is, as I understand, not a competitive auction and the scheme there looks like EUR 160+ per MWh for 20 years so potentially very attractive even though the CAPEX, as you mention though, it might be a little bit higher. So those are my three questions. Thank you.

0.57.52

Henrik Poulsen

Thanks. On the guidance you are right in saying that the underlying business we essentially maintained the guidance implicitly as we simply added the expected gain on the Riffgrund 2 farm down to the guidance. Clearly, we have had a strong first half when it comes to operations and that obviously also supports our guidance for the full year. I don't want to start speculating about whether we are going to be in the upper or lower end or mid end of the range, I think that is why we use the ranges, obviously, that we don't know just yet exactly where we are going to come out but I would only say that the first half has clearly been a good beginning to the year.

When it comes to the 11-12GW by the end of 2025, whether it is conservative or not, difficult to tell, I mean we are still building the pipeline, we are still opening up new markets to substantiate that pipeline and for now we would rather just stay focused on making sure we get good projects that generate good shareholder value to fill up that strategic ambition. Should there be more volume in the market that we can access and still create good returns, we certainly wouldn't hold back. So there is nothing essentially holding us back if we could get more projects than the ambition that we have stated here. But for now I would say this ambition is still a lot of work to be done.

Returns beyond 2020s we will not give you specific return expectations but both in Taiwan and the US we are comfortable that we will be able to create value and we see both markets developing in quite a positive

manner, not only Taiwan but also the US and maybe on that note I should just emphasise that to us the US is not just Massachusetts. With a partnership in Virginia we have moved into another state and we also continue to mature the project we have in New Jersey. So we see a number of opportunities along the Eastern seaboard in the US. But specific return expectations, that would be way too early.

1.00.10

Operator

Thank you, we now go to Marcus Bellander at Carnegie. Please go ahead, your line is open.

1.00.16

Marcus Bellander

Thank you, two questions from my side. First of all, the Hornsea 1 project, it now sounds like you are pretty sure that you will farm it down whereas at the Capital Markets Day last year you indicated that you were at least playing with the idea of not farming it down. If you could just explain why you have decided to farm it down, what your thought process has been? And then second, Henrik, you mentioned the Dutch tender and you said that you might participate. I am just wondering what would make you not participate in that tender? Thank you.

1.00.55

Henrik Poulsen

Thanks, Marcus. Back at the Capital Markets Day, our thinking on Hornsea 1 altogether was actually not all that progressed, we were still quite busy looking at the farm downs of Riffgrund 2 and Walney Extension and we hadn't really launched a dedicated effort on Hornsea 1 so we had relatively little that we could say in terms of whether we were going to do it or not. Since then, we have been moving the process forward and the most important argument why we have ultimately decided to explore farm down is that it is a huge project, obviously, just in terms of capacity, being the world's largest wind farm, but also in terms of value and value creation, it is a very significant component, even for us, and that is why we believe that in terms of just single asset risk exposure we are better off mitigating it as long as we can at least preserve all of the NPV that we would have had if we had retained 100% of the asset.

When it comes to the Dutch tender, we have a lot of things going on at the moment so the project is working on a broad front. We have not yet received the full and final details on exactly how the tender is going to play out in terms of selection criteria so we still are just waiting for the final tender regulation to come out before we can assess whether it is a project where we should spend our resources. We have a lot of projects around the world competing for resources right now and we just want to make sure that we pursue the best opportunities in that pipeline portfolio.

1.02.42

Marcus Bellander

Alright, thank you. And also thank you for the extra clarity on the construction versus farm down gains.

1.02.51

Henrik Poulsen

Thank you

1.02.53

Operator

Okay, we now go over to Iain Turner at Exane BNP Paribas and by the way just due to time constraints could you please limit your questions from now on to one question each? Iain, please go ahead, your line is open.

1.03.07

Iain Turner

Thanks very much, can I just ask about this Hornsea auction that is going on at the moment, well the auction you are bidding Hornsea 2 in, how does your successor otherwise in that auction interrelate to any decision to farm down Hornsea 1?

1.03.25

Henrik Poulsen

Well, the Hornsea 1 farm down is, as I mentioned, is very much driven by consideration around firstly single asset risk exposure and that wouldn't change, regardless of the outcome of the upcoming UK auction and secondly we are convinced that we can farm down while retaining all of the value that we have in the project so that also means that the risk diversification to us is quite meaningful. Again, all of that is essentially unrelated to the outcome of the Hornsea 2 auction. It is clear, if you don't get a Hornsea 2 project and you don't get other projects, you would obviously be spending less CAPEX in the future which would increase your financial headroom but at the end of the day our future CAPEX requirement needs to be seen across all markets and across the entire pipeline so no doubt, we would very much like to get out of the auction in the UK with a winning bid for Hornsea 2 so it is an important part of continuing our journey in the UK but it is not the end of be all for DONG Energy.

1.04.43

Iain Turner

Thank you.

1.04.45

Operator

Our final question for today is from the line of Kristian Godiksen at SEB. Please go ahead, Kristian, your line is open.

1.04.54

Kristian Godiksen

Thank you, I have a long list of questions but I guess I need to restrain myself so firstly you have previously said that you do not create value when farming down your wind parks, now a substantial value creation is the risk diversification needed Hornsea 1 gets its farm down due to the latter but I am puzzled about how we should think about the remaining of your wind parks and do you have a threshold regarding size when we think about risk diversification? And then I guess just a household question on, Henrik, you mentioned that your net debt/EBITDA will go up as CAPEX will be higher than your operating cash flow, the clarification is: does that take into account the proceeds of both Hornsea and the Walney Extension? Thank you.

1.05.40

Henrik Poulsen

Thank you, Kristian. The long list of questions, clearly we have still opening hours also past this call so don't hesitate, we are still around. When it comes to future farm downs, the argument of risk diversification, I could see two types of risk diversification, one is that the asset is so big that even against our balance sheet it justifies us diversifying it from a single asset risk exposure and that is what is one of the key drivers of us pursuing the Hornsea 1 farm down. The other type, and I would also state quite clearly that post Hornsea 1, I don't think that we will be looking at single asset risk exposure as a key driver for any future farm downs beyond that because at a certain point our balance sheet and our portfolio grows to a size where the single asset risk exposure no longer becomes a key driver. But there is another type of risk that we duly need to consider which is market risk and I could see in the future situations where we want to diversify some of our market risk through partnerships.

On the net debt side what we are saying is that for the coming quarters we would expect net debt to trend up as we continue to spend more capital than the cash flow we generate. When you look at the farm down in Hornsea 1 that you refer to, that is a 2018 or 2019 event so it is not within the time horizon of the coming quarters. When we talk about financial headroom or excess financial headroom, as I mentioned before, we are to the end of 2018 or into 2019 before we hit that inflection point and within that sort of time horizon we will farm down Walney Extension but we may not have farmed down Hornsea 1.

1.07.47

Kristian Godiksen

Okay, just a follow-up on the farm down part. Two things, so my first question would be you see yourself creating value now by these farm downs, as I believe you do, and then secondly you said that no single

asset post Hornsea 1 would be too large, I guess Hornsea 2 is also a rather large project but that would fall under the market risk I guess under your UK projects? Thank you.

1.08.13

Henrik Poulsen

The Hornsea 1 project would potentially also be a very significant project to more or less the same size, I guess, but we will continue to add projects, obviously, to our portfolio and balance sheet and as time goes by, it would take a very significant project for it to be significantly big to justify a farm-down on the grounds of single asset risk exposure, so I would maintain the point that beyond Hornsea 1, that is probably not going to be the key driver of future farm downs. But on the market risk side I could certainly see that being an argument.

1.08.54

Operator

Okay, as that was the final question for today, Henrik, can I please pass it back to you for any closing comments at this stage?

1.09.05

Henrik Poulsen

No, I would just thank everyone for joining today's call. When I look at the first half of this year, I will just wrap it up by saying that strategically, operationally and financially I would claim that the company has never been in better shape. We feel we have a very strong platform for what we have ahead of us in terms of long-term green growth, value creating growth. So on that note, thank you all for joining in and thank you for all of the good questions.