

Dong Energy A/S

Transcript :: Q1 2017 results::

Operator

Hello and welcome to the call for DONG Energy Interim Report for the first quarter 2017. For the first part of this call, all participants will be in a listen only mode and afterwards we will have a question and answer session. Speakers, please begin your meeting.

0.00.15

Marianne Wiinholt

Thank you and good morning everyone. Welcome to this Q1 presentation. I am here today together with our Group CEO, Henrik Poulsen. Our first quarter has been a good start to 2017. Financially, the quarter was as expected and therefore we reiterate our full-year expectations with EBITDA expected to amount to DKK 15-17 billion and gross investments expected to total DKK 18-20 billion. All our Wind Power-projects in the build-out plan progressed according to plan and we continued to strengthen our post-2020 build-out plan as proven with the German win of three projects in April.

If we then move on to the Group financial highlights on page 3, you will see that both our reported and underlying EBITDA was DKK 3.3 billion for Q1. Our underlying EBITDA declined by 19% compared to the same quarter last year which was positively impacted by the farm down of Burbo Bank Extension and high construction activity. For the full year 2017, we expect gains from construction contracts to exceed the DKK 7 billion realised in 2016.

Where the farm downs give some lumpiness in our quarterly reporting we are happy to register a 21% increase in our earnings from wind farms in operation.

Q1 2016 was positively affected by one-off payments from renegotiations and earnings from the now divested gas distribution activities. These non-recurring items amounted to DKK 3 billion in Q1 2016.

The net profit from continuing operations was DKK 1.2 billion compared to DKK 5 billion last year. The decline is explained by the lower EBITDA, including the non-recurring earnings of DKK 3 billion in Q1 last year.

Oil and gas continue to deliver strong operational and financial results.

If we then turn to page 4, the free cash flow came in at DKK -1.5 billion and the CAPEX spend was DKK 2.5 billion of which 80% went into the build-out of our wind farm assets.

In the first quarter 2016, we generated a free cash flow of DKK 7.1 billion and the big delta year over year is explained by the lower EBITDA, funds tied up in the construction of transmission assets and the divestment of 50% of Burbo Bank Extension in Q1 last year.

Our net interest-bearing debt increased to DKK 6.5 billion from DKK 0.9 billion at the end of Q1 2016 due to negative free cash flow and dividend payout to shareholders of DKK 2.5 billion. Our oil and gas business contributed with a positive free cash flow of DKK 2.1 billion.

Our key credit metric FFO/adjusted net debt stands at 46% at the end of Q1. Significantly above our target of 30%.

The return on capital employed for the last 12 months increased to 17% from 15% in Q1 last year and this reflects healthy returns on our portfolio.

If we then move on to the business units, we start with Wind Power on slide 5. The highlights so far this year have been the award of the right to build three wind farms in the German part of the North Sea and the completion of Burbo Bank Extension in April making us the first company in the world to deploy the 8MW wind turbines. We increased our wind power production capacity by 24% to 2.1GW driven by a 291MW new built capacity at Gode Wind 1 and 2. The first power was generated from Burbo Bank Extension during November 2016 and the last turbines were taken into production in April and this has added additionally 129MW capacity to our portfolio.

Wind Power's EBITDA declined by DKK 800 million to DKK 2.1 billion but we saw a 21% increase in EBITDA from sites, O&M and PPAs to DKK 2.1 billion driven by higher power production and the increase here was 24%.

The contribution from construction contracts and divestment gains was DKK 300 million and this was DKK 1.3 billion lower than the same quarter last year where 50% of Burbo Bank Extension was divested and the construction activity was higher related to Gode Wind 1 and 2. Again, the construction gains will come later this year and we also expect to farm down Walney Extension later this year.

Other including A2SEA and project development improved slightly to a minus of DKK 300 million due to the restructuring of A2SEA.

We are in an advanced stage of this Walney Extension farm down and we have also initiated the farm down process for Borkum Riffgrund 2 which we expect to complete in 2018.

Wind Power's ROCE for the last 12 months improved to 15% from 9% in Q1 last year and this is very much driven by the 50% farm down of Race Bank in December 2016.

If we then turn to slide 6 and an update on our other wind power metrics, following weak winds in January both February and March were close to a normal year. Our Q1 wind energy content was indexed 105, which is 6 percentage points below Q1 last year and 15 percentage points below a normal wind year.

Compared to last year, the availability was 4 percentage points higher, which was primarily due to the Walney Extension cable failure in 2016.

So despite the lower WEC, the higher availability results in a load factor of 50% in Q1 2017 which is 4 percentage points higher than Q1 2016.

We then move on to Bioenergy & Thermal Power on slide 7. We inaugurated the biomass converted Studstrup and Avedøre CHP plants at the end of 2016 and the conversions meant that we generated large volumes of heat from biomass in Q1 2017, which gives an increase in revenue compared to the same period last year despite warmer weather.

EBITDA increased on the back of the heat generation activities as we pay lower duties on heat generation from biomass compared to generation based on fossil fuels. We are still experiencing a challenging power generation market where the spreads in Q1 2017 were negative and this led to more negative EBITDA impact from power generation.

The EBITDA from ancillary services remained stable around DKK 100 million. The construction of the REnescience waste treatment plant in the UK is progressing according to plan and we expect to commission the plant in Q2 2017. We continue to run a very lean business and the continued conversion of our thermal fleet to firing with biomass will ensure that we will drive long-term profitability in the thermal business and we still expect to reach a positive cash flow by 2018.

Let us then turn to page 8 and Distribution and Customer Solutions. In the first quarter of 2016, we received DKK 2.8 billion in lump sum payments from the renegotiation of long-term gas purchase contracts and this coupled with the divestment of our gas distribution grid in Q3 2016 results in a reported drop in EBITDA of DKK 2.7 billion.

The underlying EBITDA, on the other hand, improved by DKK 300 million primarily due to improved margins from renegotiated contracts. The free cash flow generation in DCS decreased by DKK 1.5 billion, mainly due to lower EBITDA, which was partly countered by less funds tied up in gas inventories and lower trade receivables.

The lower EBITDA also resulted in a decrease in ROCE where the high figures reflect that both periods were impacted by the one-off payments.

As in the annual report, Oil & Gas is presented as assets held for sale and discontinued operations. The divestment process is progressing according to plan and we still expect to close the transaction in 2017. In the first quarter of 2017, Oil & Gas delivered very strong operational and financial performance and compared to the first quarter of 2016, the total costs and investments were reduced by 70%. The strong performance led to an EBITDA of DKK 2.4 billion, net profit of DKK 1.4 billion and free cash flow of more than DKK 2 billion.

This concludes the performance review of our business units and now I will continue with our energy and currency exposures for our continuing operations which can be seen on slide 10.

On the slide, you see our accumulated energy and currency exposures from Q2 of 2017 until the Q1 2022 before and after hedging. The GBP exposure is almost fully hedged for 2017 and 2018 at DKK 9.4 and 9.1 to GBP, respectively, and in 2019 also significantly hedged at an average of DKK 8.9 to GBP. As previously mentioned, the expected proceeds from the Walney Extension farm down are fully hedged. The open exposure from GBP implies that a 10% devaluation of the GBP versus DKK will reduce our cash flows by DKK 1.7 billion accumulated for the 5-year period.

Looking at the remaining exposures, the power exposure is almost fully hedged from 2017 into 2019 where most of the exposure relates to our wind generation. Other than that our exposure towards USD, power spreads, oil and gas is rather insignificant.

If we then move on to the next slide, we will briefly look into our management of interest rate and inflation exposure. Overall, we employ an asset and liability matching approach where we assess the interest rate sensitivity of each of the major income streams and then we match it with an amount of debt with a similar duration.

Any change in the value of our assets caused by changing interest rates will then be partly mitigated by an opposite change in the market value of our debt. However, note that currently not all categories of assets have gross debt allocated to them because our debt capacity is not fully used.

Similarly, we aim at matching our nominal cash flow so that the medium to long-term fixed nominal cash flows from wind farms largely match our long-term fixed-rate nominal debt. This prudent approach to managing our portfolio means that for example a 3% upward shift in inflation would change the NPV of our exposure subject to inflation with a modest DKK minus 100 million implying that we have a neutral risk position here.

The high certainty of our short and mid-term cash flows is furthermore reflected by the fact that 89% of our short and mid-term debt is fixed-rate debt.

Then, finally, we move on to slide 12. As earlier mentioned, we maintain our guidance on Group EBITDA in the range of DKK 15-17 billion for 2017 and we still expect to complete the farm down of Walney Extension as well as the divestment of the Oil & Gas division in the calendar year 2017.

We also maintain our expected gross investment range which is DKK 18-20 billion for 2017.

Then, I will open up for questions.

0.15.46

Operator

Thank you. Ladies and gentlemen. If you do wish to ask a question, please press 01 on your telephone key pad. If you wish to withdraw your question, you can do so by pressing 02 to cancel. We will have brief pause while questions are being registered.

The first question comes from the line of Kristian Johansen from Danske Bank. Please go ahead. Your line is now open.

0.16.08

Kristian Johansen

Yes, thank you. So to start out let us look at the construction contract and farm down gains earnings which you probably saw we have some difficulties in forecasting. I understand the majority of the at least DKK 7 billion you are guiding for 2017 will be the Walney Extension farm down. You probably cannot be very specific, but sort of the underlying or sort of the earnings excluding debt can you sort of help us in terms of how we should forecast that for the rest of the year?

0.16.43

Marianne Wiinholt

Thank you, Kristian, for the question. First of all, we have not guided for DKK 7 billion in construction gain for 2017. What we have said is that the total earnings from Wind Power will exceed what we delivered in 2016 and we have said that we should be higher than the DKK 7 billion we delivered in 2016. We fully recognise the lumpiness of the construction gains and you are right, a big proportion of the farm down gains will come from Walney Extension but we will also have significant construction gains from Race Bank, we will also have some construction gains still from Burbo which we completed here in April and we will also have a bit on Gode Wind where we have some last gains. On the remaining part of Wind Power, we have also said that we expect to complete. Gode Wind is completed, Burbo Extension is completed, we will also have some production coming from Race Bank so we will see this production increasing so we also will see the site earnings going up compared to 2016. So I don't know whether that answered your question but I guess that is what I can say for now.

0.18.17

Kristian Johansen

Oh, not really, I guess what I am after here is obviously looking at the DKK 311 million you book in Q1, should we expect that to ramp up in Q2 given the things you just mentioned like construction gains and ...

0.18.31

Marianne Wiinholt

Yes, absolutely.

Kristian Johansen

..from Race Bank and so on.

Marianne Wiinholt

Yes, absolutely. So it is not only the Walney where you should be waiting for it. You will also see a ramp up due to especially Race Bank.

0.18.44

Kristian Johansen

And how will that trend be over the year, I mean, are we going to see an increase in trends of Q2, Q3, Q4 or I mean is there any lumpiness you can help us with over the coming three quarters? Besides, obviously, divestment of Walney.

0.18.56

Marianne Wiinholt

I think in general we have more construction activity in the two mid-quarters because in the winter in a way we – if the winter period is tough we cannot do the same amount of construction work in Q1 and Q4. So from these construction agreements we will have more construction gains in the mid-quarters.

0.19.20

Kristian Johansen

Okay, that was helpful. Thank you. Then my second question on DCS, you report underlying earnings to be up DKK 0.3 billion while you are still guiding for significantly lower earnings for the full year, can you just help me understand what you expect will hit you in the coming quarters?

0.19.45

Marianne Wiinholt

Yes, we have had a strong Q1 in our Sales & Markets division and we see some volatility in the earnings so it is not that we expect Q1 in markets and sales to be repeated for the next quarters.

0.20.07

Kristian Johansen

So is it fair to conclude that the DKK 300 million increase here is sort of better than what you originally planned for?

0.20.14

Marianne Wiinholt

Yes, that is fair.

0.20.17

Kristian Johansen

Excellent. And then my last question. You alluded to it earlier just on the production from Race Bank, when do you sort of expect to produce the first power from this?

0.20.31

Marianne Wiinholt

I can't say that. We are not that specific.

0.20.34

Kristian Johansen

Okay, fair enough. That was all from me. Thank you very much.

0.20.39

Operator

The next question comes from the line of Deepa Venkateswaran from Bernstein. Please go ahead. Your line is now open.

0.20.46

Deepa Venkateswaran

Thank you. I am going to focus my questions actually on your zero subsidy bid because you mention that that was one of the highlights in April so I had two questions so firstly, do you have any indication from the German authorities on how they may view it if you walk away from this bid in 2021? And secondly, would you consider taking further merchant power risks in other jurisdictions going forward? I.e. is this heralding a

shift in your business model from you know regulated streams to basically taking on more merchant power risk? Thank you.

0.21.25

Henrik Poulsen

Thank you Deepa. I will try to answer that. No, we have not had a specific discussion with the German authorities on the scenario where we potentially would not make the FID by 2021. Clearly we are going into this with a clear expectation that we will be looking at a very good business case come 2021 and our starting assumption would still be that we will be able to make an FID and create meaningful value from these projects. This is what all our indications are suggesting at the moment so unless it changes we would certainly move the projects forward and so the optionality of potentially walking away is built into the German auction rules so I think they are relatively clear-cut and I do believe the German authorities are quite aware of the rules that they put forward for this but we moving forward with these projects being quite excited about the volume that they add to our pipeline and also the financial opportunity we see in this as we explained a couple of weeks ago in the analyst call, we do expect very material cost reductions on this horizon seven years out and we also do believe that these cost reductions will drive our cost of electricity well below our forecast wholesale power price level in Germany which we do believe is a relatively conservative price forecast compared to the external analyst forecasts that are out in the market.

When it comes to taking on more merchant power risk we do not want to extrapolate the outcome of the German auction to future auctions and tenders. Markets and auctions differ quite a bit as you know. Obviously, the German situation was special in the sense that we do not construct the transmission assets. We had a very strong site with very high wind speeds. The German authorities opened up for extension of the lifetime to 30 years and then most importantly it is with such a long horizon that we can be planning for the next turbine platform to be available. In other markets and tenders and auctions coming up we would not have those same basic parameters available to us. And therefore, we would also expect outcomes that will differ from what we saw in Germany so to answer your question more specifically I do believe in future auctions and tenders you will see markets where we will still have fully regulated income streams coming also from future wins in the market. And then, as we also mentioned in the call a couple of weeks ago, when you look towards 2020 at the time of the IPO we said that 80-90% of our total income stream would come from regulated and contracted income and a couple of weeks ago we extended that projection to also cover all the way out through 2025 including construction of the German zero bid projects so even including those projects we would by 2025 still be looking at being well within the 80-90% range of contracted and regulated income.

0.24.46

Deepa Venkateswaran

Thank you.

0.24.49

Operator

The next question comes from the line of Casper Blom from ABG. Please go ahead. Your line is now open.

0.24.55

Casper Blom

Thank you very much. I would like to just follow up a little bit on Kristian's question regarding DCS. Has there been any particular strength in your trading function here in Q1 explaining the how to say unexpectedly strong Q1 earnings in DCS? That is my first question, please.

0.25.19

Marianne Wiinholt

We have had a strong result in market trading in Q1 but the result is not only driven by strong market trading results. It is also higher margins from these gas sourcing contracts so it is a combination and the margin is actually the largest part of the explanation.

0.25.40

Casper Blom

Okay, so we should sort of still stick to the message from the CMD that the trading function is how to say low-risk?

0.25.51

Marianne Wiinholt

We operate with very, very low VaR levels and stress levels so it is a limited and very contained risk profile in the trading activities.

0.26.03

Casper Blom

Okay, good to hear. Then my second question relates to your discontinued business or the oil and gas business so to say. You mention these extraordinaries in terms of the end of hedging contracts and the Siri platform and can you give some sort of number as to what clean EBIT or clean earnings in the division was/were here in the quarter?

0.26.29

Marianne Wiinholt

Actually, when you adjust for the ineffective hedges and this compensation then we are approximately at the same level as we were in Q1 2016. So..

0.26.43

Casper Blom

Okay

Marianne Wiinholt

Yes.

0.26.46

Casper Blom

Okay that is good to hear and just to be sure about these hedges, we should basically just think about it as if you still have your hedges for 2017 on the oil price and then it ends. Is that the way to think about this?

0.26.58

Marianne Wiinholt

Yes, because we don't assume that we own the oil and gas business in 2018 or 2019 where we still have some hedges then we cannot consider them in a way hedges anymore. Then we have to do them market to market, so this is the market to market value of the hedges from 2018 and 2019.

0.27.14

Casper Blom

Okay, perfect. Then my final question relates also to the German zero subsidy bids from Easter. I was wondering have you been sort of receiving any type of feedback from your direct investors on making such a move? There have been some newspaper articles in Denmark about some investors asking for higher cost of capital in this type of scenario where you are exposed towards the market price. Is this something that you have sort of been in discussion with your direct investors about or is it really not something we worry about because farm downs are not relevant in 2024?

0.27.55

Henrik Poulsen

It is not a discussion we have had Casper. We would now be spending our time on developing the business case further towards 2021 and the FID. We are quite confident about the cost estimates we have put down. We also feel very good about the commercial assumptions we have made but obviously we will be spending the coming years further detailing and substantiating the business case ahead of an FID and only when we get to an FID will we find it relevant to start potential discussions with co-investors so that is something we still have ahead of us. Our current discussions with co-investors are all focused on Walney Extension and Riffgrund 2.

0.28.42

Casper Blom

Okay, so the additional 250 basis points that you have been adding to your cost of capital that is entirely something that is sort of decided within DONG Energy and not something that any external parties have had a say about.

0.28.55

Henrik Poulsen

That is entirely our decision to raise the cost of capital requirement on these projects reflecting the increase or the potential increase in merchant power risk.

0.29.07

Casper Blom

That is very clear. Thanks for taking my questions.

0.29.11

Operator

The next question comes from the line of Timothy Ho from Morgan Stanley. Please go ahead. Your line is now open.

0.29.17

Timothy Ho

Hi, good morning. Two questions from me. The first is would you be able to provide more colour on the new jurisdictions where you can see offshore wind becoming an increasingly important part of future energy plants, especially given the zero subsidy bids in Germany and as a link to that, are there particular countries where there are opportunities to buy leases? And, secondly when you talk about external forecasts in markets German power that you are conservative relative to is there kind of a range of forecast that you can share with us?

0.29.52

Henrik Poulsen

Thank you, Timothy. I will try to answer the first question on the jurisdictions. It is quite clear that the development within offshore wind has been sort of very rapid over the past, especially the past two years. I believe governments, policy makers around the world are only now beginning to fully realise the competitiveness of offshore wind in terms of the benefits, not only the cost competitiveness now being very strong, but obviously all of the green credentials of offshore wind. And we are of course engaging in dialogue with governments around the world to make them fully aware of what we have to offer as an

industry and also DONG Energy specifically. I do remain quite convinced that this will lead to additional global market growth over the coming five, ten, fifteen years. I do believe we will see more markets engaging in offshore wind at a meaningful scale and we are obviously staying close to all of those market opportunities.

In terms of specifics, you do know that we are of course already well established in the US in terms of pursuing the opportunities that will come up on the US East Coast over the coming years. We are also going full speed in Taiwan in terms of further developing our studies of the 2000MW of capacity that we are currently exploring in Taiwan and both of those markets we remain quite optimistic about the long-term growth prospects. We also do see additional markets now beginning to gradually open up and engage with us in discussions. Those are still relatively early discussions with governments in different parts of the world so I will rather not become too specific too early on those opportunities. But in terms of global momentum we see clearly interest in offshore wind trending up across the world.

On the external power forecast, we have not made anything public in terms of specific benchmarks but you are all aware of the four to five leading external analyst firms that publish power price forecasts and those are the ones that we refer to.

0.32.18

Timothy Ho

Okay, thank you.

0.32.21

Operator

The next question comes from the line of Marcus Bellander from Carnegie. Please go ahead, your line is now open.

0.32.28

Marcus Bellander, Carnegie

Thank you, a couple of questions from me. First, when you farmed down Race Bank there was a bit of a delay, I think it was, interest rates were moving around, the pound was volatile. Is there any risk of a delay in the Walney farm down due to such factors?

0.32.47

Marianne Wiinholt

That is not something we are looking into. The process goes exactly as planned and we don't see any delays in the process.

0.32.57

Marcus Bellander

Alright, that is great. And then just a housekeeping question, I suppose. In Oil & Gas you reported a very steep decline in operating costs. Was that due to the one-offs that were sort of booked in the quarter?

0.33.19

Marianne Wiinholt

When we talk about the 70% reduction, it is a combination of OPEX and CAPEX so a lot of it is also driven by CAPEX but it is also the impact of the reductions we have made with the exploration activities and also staff reductions. So it is a combination of all three things.

0.33.39

Marcus Bellander

Yeah, but I think the employee costs and other external expenses were 180 million in the quarter whereas they were 600 million in Q1 2016.

0.33.48

Marianne Wiinholt

Yeah, but that was some of the exploration costs also impacting there.

0.33.54

Marcus Bellander

Okay. And the fact that there is no depreciation and amortisation in Oil & Gas now, why is that?

0.34.01

Marianne Wiinholt

That is actually accounting rules. We would have liked to continue with the depreciation but according to the accounting rules, you are not allowed to do it when you have put it as discontinued operation.

0.34.15

Marcus Bellander

Okay, okay. That is helpful. Thank you.

0.34.20

Operator

The next question comes from the line of John Musk from RBC. Please go ahead, your line is now open.

0.34.27

John Musk, RBC

Yes, good morning everyone. I think three questions, they are all sort of related to farm downs though. Firstly, with the guidance on EBITDA of 15-17 billion, assuming that you are nearing the end of the Walney farm down and must have some good visibility on the price there. What are the main swing factors within the range that you have given for EBITDA in the balance of the year?

0.34.52

Marianne Wiinholt

Yes, I can answer that. When we do these farm downs it is a combination of an upfront SPA gain and construction gains. And depending on whether you have 50% on your SPA or whether you have 20% on your SPA, you get a more or less frontend loading of the earnings. If it is the construction, if you have the majority on the construction agreement then you get more backend loading, you can say, of the earnings from the farm downs. So even if the total value is exactly the same, you can get timing differences, depending on exactly how the deal is done.

0.35.31

John Musk

Okay. And then on Walney, maybe just a bit of background colour on how that process has differed from Race Bank and obviously the main difference being the one being a ROC? and Walney being a CfD. Did that change the level of interest from investors in that asset?

0.35.53

Marianne Wiinholt

Of course, the most attractive assets from an investor point of view are the CfDs because they don't have any merchant risk in the first 15 years. But what actually delayed the Race Bank was Brexit and it was not, in a way, the project is an extremely attractive project so we had a lot of interest but it was really the Brexit that delayed it.

0.36.14

John Musk

So should we assume that the headline rates or the headline price on Walney should be higher than that which we saw on Race Bank?

0.36.26

Marianne Wiinholt

I can't give you that level of detail. And we need to complete the transaction first also.

0.36.35

John Musk

Okay. That alright and just finally back at the Capital Markets Day you obviously talked around not having to necessarily continue with farm downs indefinitely. Can you just confirm, I am not sure I am fully clear that the Borkum will be definitely farmed down or is that still up for discussion?

0.36.56

Marianne Wiinholt

No, Borkum will be farmed down.

0.37.00

John Musk

Okay. That is great, thank you.

0.37.04

Marianne Wiinholt

Welcome.

0.37.05

Operator

The next question comes from the line of Kristian Godiksen from SEB. Please go ahead, your line is now open.

0.37.12

Kristian Godiksen, SEB

Thank you. A couple of questions. Firstly, I was wondering with the major step-down in the cost for the new turbine platform, what is the risk that upcoming tenders/auctions will be postponed/extended to be commissioned in 2025 to save government taxpayer money? Secondly, what action is it that you expect the EU to do to reinvigorate the CO2 trading scheme? And then thirdly, what was the impact in Q1 from the lower wind energy content? It would be very helpful if you could give some sensitivity on, let's say, one percentage point change in your WACC and which impact it would have on your EBITDA. Thank you.

0.38.03

Henrik Poulsen

Alright, thanks Kristian. On the turbine costs, I don't see any indications that any governments would postpone the auctions and tenders that we have coming up over the next 15-18 months. I do believe that they will all benefit from the significant cost reductions we have seen across all parts of the offshore wind value chain over the past couple of years and I do believe they are all looking forward to reaping those benefits in upcoming auctions and tenders. So we see no indications that there will be any postponements.

On the CO2 pricing we have seen fairly specific proposals now from the Commission that we expect to be implemented towards the end of the decade, early next decade, to basically stabilise the supply-demand balance on the CO2 quotas through a so-called market stability reserve and also an annual reduction of the excess supply in the market where they will on a continuous basis be taking out excess supply quotas to support a stronger and more stable long-term price on CO2 as a driver for the green transformation within the EU. So those are the proposals that we are looking into. As we saw, as we also said in the analyst call a couple of weeks ago, we see external forecast predicting a CO2 price long term to the tune of EUR 30-40/ton in real prices. We have not taken our assumptions to nearly that level. We remain quite conservative in our assumptions on the future CO2 price relative to what we see in external forecasts.

0.40.08

Marianne Wiinholt

And the last question I can answer. We still have the guidance we also gave at the Capital Markets Day that one percentage point lower wind energy content gives for a full year an impact of approximately DKK 80 million.

0.40.26

Kristian Godiksen

Perfect, alright, thanks a lot.

0.40.31

Operator

The next question comes from the line of Mark Freshney from Credit Suisse. Please go ahead, your line is now open.

0.40.36

Mark Freshney, Credit Suisse

Hello, morning. I have three questions, firstly on the Oil & Gas production business. Can you – are you saying that you have cashed out the ineffective hedges for future years? Can you give a bit more colour there? Secondly, it was a very strong result but given the sales process that is on-going, is there a lockbox

structure where you won't be able to extract the very strong free cash flow out of that business? And thirdly, I know we have asked before and it is not being disclosed but on the revenue recognition for the construction and divestment business within Wind Power, is it fair to say that cash flow generation was very poor and therefore so was profit generation? Because the profit generation very closely matches the cash flow generation and therefore can we expect a very strong Q2 once you get the cash proceeds in from Burbo Bank?

0.41.51

Marianne Wiinholt

Thank you, Mark. I will answer question one and four and then I will give two and three to Henrik. On Oil & Gas hedges, no, we have not cashed out the Oil & Gas hedges, it is just accounting so that we need to take them up to market value into the P&L but we will only start unwinding the hedges when we have enough certainty around the transaction. So no cash impact there.

Then the construction gains. No, there is no connection between the cash and the way we take the construction gains through the P&L. The P&L is driven by the progress on the construction progress so the degree of completion and completely dealings from cash. And then Henrik will answer two and three.

0.42.41

Henrik Poulsen

Yeah, Mark, if I understood the question correctly, it basically goes to the cash generation in the O&G business in Q1, whether that would be retained or not in a divestment. And it is clearly our expectation that the cash we have been generating year to date in the Oil & Gas division would be retained by DONG Energy in such a transaction.

0.43.04

Mark Freshney

Okay, thank you very much.

0.43.07

Operator

The next question comes from the line of Jenny Ping from Citi Group. Please go ahead, your line is now open.

0.43.13

Jenny Ping, Citi Group

Hi, morning everyone. Just a follow-up on John's question earlier in terms of the swing within the EBITDA as a result of the Walney farm down. If I understand correctly, Walney Extension is the EPC wrap, right, which means it is less front-loaded than Race Bank which was a shared risk. So therefore would the swing be that

big? That would be the first question. And then second question I wanted to get some sense of your net debt number. Net debt 6.5 billion seems to be a lot higher than at least what I was going for so could you give us some sort of feel in terms of the profile of that? Why it is so high and the profile of that for the rest of the year? And then lastly, in the notes at the back in the operating income expenses on page 29 of your release you talk about a gain on divestment of assets on the back of adjustments of the purchase price of London Array. Can you just elaborate on what that is exactly? Thank you.

0.44.31

Marianne Wiinholt

Yes. First the swing related to Walney Extension. You cannot really necessarily compare Race Bank and Walney Extension. When we do this split between the SPA and the construction gain we also look into tax and therefore it might be that quite a big proportion of this deal will actually go to the SPA part and be front-end loaded. But this is something where we do not have full certainty yet so therefore there is still some uncertainty we need to take into account in our range for the EBITDA guidance.

0.45.17

Jenny Ping

Sorry but it is fair to say that Walney Extension recognition won't be as front-loaded as Race Bank was?

0.45.26

Marianne Wiinholt

Not necessarily, actually, Jenny. It is a bit more complicated than that. So it is also depending on the negotiations we have with the partner. So therefore we can't actually say it yet. It might be to the same level but it is another, it is an EPC wrap so it is another accounting treatment and it goes through the revenue line and the cost of sales line which Race Bank doesn't. So yeah.

0.45.55

Jenny Ping

Okay. Thank you.

0.45.57

Marianne Wiinholt

On the net debt, the reason for the net debt increasing is very much the net working capital movements, as you know, and in this quarter we are building up working capital on the OFTO assets, both on Hornsea but first of all on Walney. And that we will continue to do, have on our balance sheet until we divest the OFTOs, which we expect to do 2018-2019 for these two assets. And then on top of that we have not had any milestone payments from our partnerships in this quarter. But we expect that to come later in the year so

then we will see a positive impact from that. But we expect it to be cash flow negative in 2017 and unfortunately I can't say by how much but this is very much in line with our expectations.

And then the third question you had was around these adjustments to Walney. Sorry, London Array. We had some agreements in the London Array documentation where we now get an additional payment due to higher production so this is just a payment for that.

0.47.22

Jenny Ping

But is that a one-off or is it a repeatable?

0.47.25

Marianne Wiinholt

It is a one-off.

0.47.28

Jenny Ping

Right. Okay, thank you.

0.47.31

Operator

The next question comes from the line of Jørgen Bruaset from Nordea Markets. Please go ahead, your line is now open.

0.47.40

Jørgen Bruaset, Nordea Markets

Yeah, I think we touched upon most of it but I have two just quick questions from my side. So first of all, should we expect any more one-offs to come through in the Oil & Gas business for 2017? And my second question is could you just please remind us on the timeline on the on-going UK auctions? When should we expect to see the outcome of your bids in that? Thank you.

0.48.05

Marianne Wiinholt

The first question I will answer. No, we don't expect any more one-offs. The thing that could come is more effect from these hedges because of course they will fluctuate, depending on the market prices in effective hedges. And then of course we have also this Hejre project where we have cancelled the EPC contract and if we should settle on that dispute there might also come something there.

0.48.39

Henrik Poulsen

And on the second question, Jørgen, the final submission deadline for the UK auction has not been fully fixed just yet. We would expect it to be by the end of May, I believe the earliest it could be would be May 26. And if that happens, we would expect an announcement to come out anywhere between probably late June through August so somewhere over the summer we would expect an outcome from the UK auction.

0.49.13

Jørgen Bruaset

Perfect. Thank you so much.

0.49.16

Operator

The next question comes from the line of Frans Høyer from Jyske Bank. Please go ahead, your line is now open.

0.49.21

Frans Høyer, Jyske Bank

Thank you, good morning. Could you talk about the level of or changes in the level of interest from buyers, investors in wind parks that you might be seeing or the required rates of returns that they demand? The second question is a small one. I just noticed a big swing in the unallocated activities, EBITDA contribution from plus around 100 to minus 240. What is happening there? And then finally whether you could offer some more texture on the issue of negative spreads in Bio Thermal Power prices. I would like to understand that a bit more. Thank you.

0.50.12

Marianne Wiinholt

Yes. The first question, level of interest from partners, we see a similar very large interest for our wind farm downs. Unfortunately, we cannot give you the investor return requirements. That is commercially sensitive.

On this unallocated it is the effect of GBP hedges and that fluctuates, depending on which direction the GBP goes. But this quarter we have had a negative effect from this.

And on the negative spreads in Thermal Power, yes, we see a very challenged power market. It has been quite a warm winter and we also see that the hydro balance in the Nordic countries has been increasing and also actually we have had a negative impact from the coal prices being significantly higher than last year. So all in all, we have actually had negative green dark spreads this year.

0.51.24

Frans Høyer

Thanks very much.

0.51.26

Henrik Poulsen

Frans, it may be worthwhile just adding to the question of the interest, as Marianne said, we see very strong continued interest in the farm downs and to the question of the return requirements, we have over the past few years we have seen a general compression of the return requirements as we have seen more demand coming into the market in offshore wind and we have not seen that compression reversed. So we still see a pretty strong market here.

0.51.53

Frans Høyer

Thank you.

0.51.57

Operator

The next question comes from the line of Pinaki Das from Bank of America. Please go ahead, your line is now open.

0.52.02

Pinaki Das, Bank of America

Hi, good morning, thanks for taking my questions. So I have got a couple of questions. The first set of questions is on the farm downs and the second one is a simple one on the inflation sensitivity that you have shown in one of the slides. For the first one on farm downs, I just wanted to confirm my understanding. You get upfront gains from the sale of the equity stake and then you get milestone payments based on the construction. Just for Burbo Bank, for example, you have completed it in April. Have you already accounted for all of the gains within that or maybe something is going to come in April relating to Burbo Bank? And

after April, hopefully there is nothing there? And just on a related question to this whole farm down versus construction gains. Do you think it.. you know, it is quite a complicated calculation and you know the market doesn't seem to understand exactly what is going on in terms of the split between the gains and the construction revenues. Do you think you would be able to provide in the future maybe more detail around things like whatever you have done until now, how much has already been accounted for and how much is left, a bit like your hedging charts. Would you be able to provide more details so that the market can get more comfortable around the farm downs? That is my first question.

And the second one is a simple one on inflation. You have highlighted that if inflation is higher, you have a small negative impact which was contrary to my understanding. I thought that if inflation for example in the UK goes up, then your achieved power prices should go up over the long term? And actually you have got very little debt so it should be quite NPV positive if you have high inflation.

0.53.57

Marianne Wiinholt

Yes, the first one, the farm downs. Yes, we have some remaining construction gains from Burbo Bank since we just completed it here in April so there will be, it is not a lot, but there will be some in April. And then on the transparency, we believe that we already are quite transparent because you can both see the SPA gains and you can see the construction gains but you cannot see them wind farm by wind farm and there will be lumpiness so it is quite tough for us to be more transparent than we already are, unfortunately.

And then on your question on the inflation, this 100 million is just a very, very small impact so basically we are balanced as you can see on slide 11 in the presentation, you can see that we have quite a good match between the fixed nominal cash flows and the fixed rate nominal debt. We don't have 100% match on exact timing of the income and the debt but we have a close to balanced situation.

0.55.12

Pinaki Das

That is a bit surprising because your debt is very low right now and just looking at your guidance for this year for example if you look at EBITDA and the CAPEX you are kind of free cash flow neutral, maybe a little bit more CAPEX than EBITDA. So if you have very little debt so it is pretty much equity and if inflation goes up then your revenue streams go up. Why is it not massively .. why is higher inflation not significantly positive for you?

0.55.40

Marianne Wiinholt

That is because when we talk NPV we also take into account the WACC and if you see higher inflation you also see a higher WACC so of course you will see higher earnings but the NPV will not be higher since the WACC will also be higher.

0.55.59

Pinaki Das

Okay, of course. Thank you.

0.56.01

Operator

The next question comes from the line of Ian Turner from Exane. Please go ahead, your line is now open.

0.56.06

Ian Turner, Exane

Good morning. Could I ask you about your hedging and how you think about the DKK against the EUR in your hedging approach? Do you see that rate as locked or do you hedge.. just clearly you buy some things in EUR and you buy some things in DKK.

0.56.25

Marianne Wiinholt

No, we see that as locked so we don't hedge any DKK or EUR exposures.

0.56.33

Ian Turner

Thank you.

0.56.38

Operator

And we have a follow-up question from the line of Kristian Godiksen from SEB. Please go ahead, your line is now open.

0.56.43

Kristian Godiksen

Thank you, it is just a follow-up on the timing of a potential settlement of the Hejre dispute. I think you indicated a bit that that could come this year. And then secondly also regarding the inflation hedge. Could you explain which time period is it that you indicate? And so does that include the Hornsea and other CfD parks? And then maybe thirdly more of a household question. What is the length of these gas purchasing contracts and am I right to assume that the EBITDA contribution will be zero once they expire? Thank you.

0.57.23

Marianne Wiinholt

Yes. Sorry, Kristian, the first one was the timing of the Hejre dispute, yes, sorry.

0.57.32

Henrik Poulsen

I can cover that, Marianne will cover the other ones. Kristian, the Hejre dispute, as you know, we are in an arbitration process, the process is going exactly as we would expect it to. So obviously we cannot comment on an outcome until we have such a conclusion to the process. But whenever we get to either the outcome of arbitration or if we were to reach a settlement ahead of that we would obviously immediately notify the market.

0.58.02

Kristian Godiksen

Is there a possibility that could be in 2017 or is..

0.58.06

Henrik Poulsen

I would rather not comment on the timing, Kristian. I ask for your understanding that we are in a legal process here so I cannot comment on the timing.

0.58.13

Kristian Godiksen

Okay.

0.58.15

Marianne Wiinholt

Yes. Then you talked about the inflation exposure. What we include when we show this picture is all the wind farms where we have taken investment decisions. So that means that for the ones where we have inflation adjustments it is up until Hornsea. So that is included. But in Germany and in Denmark and the Netherlands we don't have inflation adjustments so then the cash flow is included in the fixed nominal cash flow.

0.58.47

Kristian Godiksen

And just to be absolutely sure, and it is the full lifetime of the, let's just take the Hornsea park that you have adjusted for? Okay.

0.58.55

Marianne Wiinholt

Yes it is. And then you talked about the length of these gas sourcing contracts. If we look at the Danish contracts, the DUC contracts, they last as long as there is gas in the North Sea. They stop in 2042 but I don't think there is much gas after that but it is very long contracts and then the Gazprom contract is also a long contract. And you are right, yes, after these contracts expire there will not be any margin from this.

0.59.28

Kristian Godiksen

Okay. And is it only DUC contracts that are left or is that the vast majority?

0.59.31

Marianne Wiinholt

No, Gazprom is also quite significant and then we have the LNG contract with Iberdrola. So those are the main contracts we have or those are the contracts we have. DUC, Gazprom and Iberdrola.

0.59.46

Kristian Godiksen

Okay and the Iberdrola and the Gazprom are somewhat similar to the DUC?

0.59.50

Marianne Wiinholt

Not as long. But also very long-term contracts.

0.59.58

Kristian Godiksen

Okay. Thanks a lot.

1.00.00

Operator

As there are no further questions, I will hand back to the speakers for closing comments.

1.00.08

Marianne Wiinholt

Yes. Thank you. In the first quarter we saw significant positive one-off items and we saw high income from Wind Power partnerships and we saw a lot of cash being released from working capital. This was in Q1 2016. In 2017, we did not benefit from any of these things but we would urge you not to pay too much attention to this because you should look through these quarterly fluctuations. Our underlying operations are very much on track, as we also highlighted, for example the growth in the profit from operating wind farms. The partnership income will come later this year and we expect it to exceed the level we saw in 2016. As such, we remain very confident about the full-year outlook. And strategically, the company is as strong as ever and we remain very well-positioned to profit from the global growth potential in offshore wind. Our technology which evidently has seen a massive step change in its competitiveness over the past few years. We take pride in having been instrumental in driving the industry forward and creating significant value for our shareholders along the way. We will continue to have the same focus. Thank you and thank you for all your questions.