Eesti Energia 2nd quarter 2010/11 Earnings Release Conference Call October 29th, 2010

MODERATORS:
MR. MARGUS KAASIK, CFO

Operator: Ladies and gentlemen, welcome to the Eesti Energia Second Quarter 2010/11 Earnings Release Conference Call. I am Maria, your operator for this conference. Please note that for the duration of the presentation all participants will be in listen-only mode and the conference is being recorded. After the presentation there will be an opportunity to ask questions. Should you need assistance during the conference call, you may signal an operator by pressing * and 0 on your telephone. At this time I would like to turn the conference over to Margus Kaasik, CFO. Please go ahead Sir.

Margus Kaasik: Welcome ladies and gentlemen to Eesti Energia's Second Quarter Results Presentation. My name is Margus Kaasik and I am CFO of Eesti Energia. Let's turn to page 3 and what we are talking today is basically highlights of the Second Quarter. Just a little bit about the business environment here and, of course, our Group financial results. Afterwards we will do a Q&A session.

Turning to page 4, Second Quarter of this financial year was a successful one for us. Our revenues were up 18 percent up to €165 million. EBITDA growth was even bigger, 23 percent up to €45 million and operating profit margin was almost 14 percent. We invested €47.6 million during that Second Quarter which is roughly in line with the amount during the last year's Second Quarter. The increase was just 5 percent.

Now about the business environment, on page 6 just a quick update on Estonian macro economic situation. We're on the route of economic recovery. The economic decline has ended and we do see that most macro-economic indicators are still having started to grow and also inflation. We also do see that as our electricity sales and consumption of electricity in Estonia is linked to GDP growth as well, we have seen a growth in our electricity sales.

On the next slide there is information about electricity prices in open markets in Estonia and, as you may know from 1st April this year, there was a launch of power exchange in Estonia with Nord Pool extended their operations to Estonia and the market has worked rather well. It has been liquid and basically what we can say, we have seen over that six-month period a harmonisation of prices of between Estonia and Finland. The spread between Estonia and Finland has decreased over time and now, actually what we do see is that the price during the second quarter was in Estonia even a bit higher than in Finland, but it was basically due to one day, where Estonian prices peaked and were €462 per megawatt hour. Other than that the prices were roughly the same in Estonia and Finland.

In the Lithuanian power pool the prices are a bit higher due to some constraints in transmission capacity and also due to a market structure it's not a similar one to Nord Pool.

Turning to our financial results, we are already on page 9. Now what we can say is that as the market has opened in Estonia, the power market to some extent and now more than half of our revenues come from open market. Be that, power sales to our eligible customers, oil sales or some other products and services and for us it's from that point of view good news as regulated prices are lower in power market than eligible or open market prices then, and definitely there is an upside to earn from market opening.

Moving to next slide, slide 10, which shows our revenues and we can see here that all our core products' revenues have increased, there is a structural shift between regulated and unregulated markets as market open, then sales in the regulated market declined, but they went over to the unregulated market and other products and services have also increased. Network services, fuels and other revenues. There's also a pie chart to indicate how much revenues we get from each product and most of the sales still come from the electricity. Power sales at regulated prices was €33 million with unregulated prices it was €57 million and network services €38, so it's a bit more than 75 percent of the revenues still come from the electricity side.

Now moving on to each of those key products. In the regulated market, well as the market opened and some clients moved to unregulated side of the sale then, of course the sales declined. The sales volume declined about 26 percent, sales in Euros declined 27 percent, so the average price also declined slightly. It was mainly due to the fact that regulated prices did decline from 1st August last year, so last year's second quarter did include one month was a bit higher regulated price. Hence, a little decline there. From market, the structure point of view just to remind that customers who are consuming more than 2 gigawatt hours per year are now being forced to buy on open market with unregulated prices. It currently is about 30 percent of the total market of Estonia, that is de facto open.

Now on the open market side the volumes, of course, have increased because well the market opening of Estonia, but also because of market opening in Lithuania where we have gained market share and currently our market share in Estonia is 87 percent and 17 percent in Latvia and Lithuania. On the open market we sell about 0.6 terawatt hours to retail customers being in Estonia, Latvia or Lithuania and about 0.8 terawatt hours, so a bit more, were sold through power exchange or through bilateral deals with other electricity market players here in the

Baltics.

Now, next slide 13 about network services. Here, basically we see that the volumes have increased about 6 percent so that does indicate that electricity consumption is on the growth pattern. That definitely helps us also in the distribution business. We see revenues going up more, 11.5 percent that does indicate that the prices of electricity or distribution services actually increased, but the increase was mainly due to transmission. Transmission fees increased and that is a, basically, a pass through element in our distribution tariff so from that price increase we didn’t gain anything, basically.

On the next slide, about shale oil page 14. The shale oil sales volumes have gone up about 16 percent, sales in Euros about 30 percent and that is, basically, mainly because the average price is higher than it was a year ago and as our shale oil prices linked to oil prices in the world market and to heavy fuel oil prices in the world market then and that changed and our sales prices changed as well. We do have somewhat hedged our position in the oil site and it was 15,000 tons per this quarter that was basically hedged at a €320 per ton. We did have a slight, slight loss from those forward agreements.

On the next slide we come to the profit side of our business and what we can see that basically the growth in the EBIT came mainly from our generation division and our fuels division and it then grew from €14 million to €22 million. The EBIT itself, if we look at the pie chart on the right side, we see that still, although the growth came mainly from generation and fuels division, than the absolute amount of EBIT, still about half of it came from the retail side and that’s mainly distribution business and almost second half from the Fuels division that is basically oil and mining. The generation business, EBIT was rather small about 10 percent of the total EBIT is also about, due to the fact that summer months are not the best for our generation business, as the market prices tend to be a bit lower and, also, the demand side is lower and the supply from our side is lower, as we use summer periods for maintaining our equipment.

Now to turning to our business divisions’ view on page 16. Retail division profitability, as you saw on the last slide didn’t change much during the last quarter. Sales volumes did grow somewhat and the prices as well, but basically as the margins are rather small and also the price increase was also due to the fact that the input prices of that electricity increase then the margin or EBIT basically wasn’t affected at all. A bit more information we have extracted from that retail division, also, the distribution business – that’s on slide 17 – that does show that our distribution business profitability decreased a bit, about €1 million and that was due to the extraordinary storm related expenses that we had. These accounted for about €1 million and the price increase that we do see in our distribution business, as I said, was basically due to the pass through elements and we didn’t gain much. Distribution business, return on invested capital currently is 6.5 percent that is roughly the same that is allowed by the regulator. Regulated return is currently is on our prices 6.7 percent so we are almost fixed achieving the allowed return.

Now on the next slide about generation business there was some growth and so basically what it was due to is that our net electricity generation grew significantly. We did have, last year some revaluation of CO2 allowances that we had purchased for covering our positions, but as our generation mix change significantly and we did import a lot last year than at some point of time we had to revalue and start to account this mark to market for those CO2 allowances and these, basically affected the last year’s second quarter results significantly. That was one thing that somewhat boosted this year’s growth and also a new item is a rental fee from Estlink Cable, as we have now given our cable to Nord Pool power exchange in exchange for basically the bottleneck fee that we get as a rental fee. These are the changes and these, basically, helped to grow the EBIT from minus 2 to €2 million. The significant change in this generation site is, as I already indicated that during last year’s second quarter we did import significant amount of electricity, we did import it from Lithuania at a pretty good prices. This year the contract expired and what we basically covered that amount of purchases by our own generation that has a lot lower margin, so basically that switch or change in our procurement mix, so-called did lower our margin significantly and had a negative impact.

On our next slide, 19 about our fuels division, there we see also EBIT growing from 6 to 10 and this division has mainly benefited from both the volume and price increases on two main products, basically. Shale oil volumes have grown and prices and as well on the oil shale sides we do sell a bit of this oil shale to third-parties and the volume of it and the price of it also increased, so that those two products both basically helped to push up the margins a bit and increase EBIT to €10 million.

Now, on page 20 about our cash flows. Our cash flows during the summer months definitely are, both this year and last year, net cash flows are negative or free cash flows we do invest more than, is our operating cash flow last year. Last year during the second quarter they were more or less equal. This time the operating cash flow was significantly lower, but it was lower due to the income tax that we paid on dividends. The timing of dividends is and paying this income tax or recognising this income tax is significantly different this year and last year. Last year we did pay some dividends during the first quarter, some during the third quarter. During this financial year we did pay out all the dividends during the second quarter so that timing affects somewhat the operating cash flow and our free cash flow as well.

Now, turning to page 21, investments during the second quarter amounted to €47.6 million. Most of the investments went to our generation side, where we are installing desulphurisation equipment into four electricity generation units, one of those is almost complete and three are undergoing. On the retail side we invested €13 million, basically almost all of this is distribution network and on the fuel side the main investment was into our new oil plant Enefit-280 about €5 million basically.

On the next slide there is a quick update on our main investment projects that are ongoing and the Enefit-280 oil plant we have invested up-to-date €33 million. The total investment is an estimated €190 million, project deadline is 2012. Second very important part in our business plan as well is the desulphurisation equipment in Narva power plants that will enable us to use those old units for much longer periods until and after the time where their derogation ends that we have got from EU too regarding those sulphur emissions. Into those FTGs we have invested €49 million and the total project is €110 and the project deadline is also 2012. From those four units, as I said, one will be commissioned already by the end of this year, this calendar year in December.

Iru waste-to-energy plant project is currently stalled a bit, because of the dispute over building permit. We are not part of this dispute, but basically the municipality who gave us the building permit is part of the dispute, but anyway it does affect how we can proceed with the project. The legal proceedings are going on and we are making our decisions, how to proceed with that project sometime in November and the project itself is €100 million and could be completed by 2012. We just recently have signed an EPC contract to build a wind park on Narva ash fields. The cost of the project is €58 million and it will also be the up and running in the end of 2011 or beginning 2012 that is already now under construction.

I'm now coming to summary, page 23, then definitely the second quarter of this financial year we regard as a successful one, as our revenues are up 18 percent, EBIT increased 59 percent. Especially proud we are of the fact that sales electricity in the open markets went up 101 percent. That does show our competitiveness on the open market. Market share is 87 percent in Estonia and 17 percent in Latvia and Lithuania. We significantly increased the sales of shale oil, that is a rather profitable part of our business and the main profitability growth came from the shale oil and also from generation side. And investments are currently still modestly are up 5 percent from last year.

That's basically the end of my presentation, but I'm glad now to start the Q&A session and glad now to answer your questions.

Operator: Thank you, sir. Ladies and gentlemen we will now begin the question and answer session. Anyone who wishes to ask a question may press *1 on their touchtone telephone. If you wish to remove yourself from the question queue, you may press *2. Participants are requested to use only handsets while asking a question. Anyone who has a question may press *1 at this time. Ladies and gentlemen, for questions please press *1. Thank you. The first question is from Taito Jokisaari from Pohjola. Please go ahead.

Taito Jokisaari: Yes hello. This is Taito Jokisaari, I'm with Phojola Asset Management. Regarding your investment projects I've seen a number of 3 billion over the next 5 years that you're planning to invest. When are you going to step up the investments if you are to reach that 3 billion and also what are your plans to finance the investments?

Margus Kaasik: Thank you. Basically those are investment projects that are already undergoing or have an investment decision behind them, have been listed in that table that you just saw and that definitely is far from that 3 billion that you mentioned. We do have, yes in the pipeline other investments, two main one, would be, one is the new power plant in Narva, new basically oil shale fired power plant. This is in the tendering phase and we may see in the next few months reaching the investment decision there as well, but it currently has not been decided. If we do that investment decision, then yes the project amount there is 2 units. We plan to procure up to two units, basically one plus one and one of those will cost roughly €500 million, and the construction would then start sometime mid next year, mid 2011. The second unit of that new power plant will be decided not sooner than 2012, so up until that we still have a lot of flexibility. And then the second leg of our investment plan is the oil plant, basically the second phase of our oil expansion. There we do the investment decision as well not sooner than 2012. What we plan to do is to first finish the oil plant that we are currently building and then after that is commissioned and working beautifully we do decide on the next ones. Just to, basically reduce the construction risk and business risk there. And now coming back to when the investment amounts would go up then, then yes, after 2012 are starting from let's say second half of 2012 we could see a significant increase, but basically not sooner. As we have said the investment decisions have not been made yet and we'll have to, basically, live to that point and see what the investment figures are, what is the profitability of those investments and so on to make those decisions. About the financing side, basically big part of that investment are financed through our own cash flow, that is a significant part. Secondly, we do have a, as you've probably noticed sometime this spring that was talk about possible IPO of Eesti Energia. Still whether it being IPO or Government or equity injection by current owner, our Government, that will most likely be an equity increase to help to finance the investment plan being outlined as you described. Of

	course we plan to adapt to debt markets as well and let's say the timing of it does depend significantly on this possible IPO. That possible IPO being sometime sooner than pushes back, that if IPO is not on the horizon soon then the first thing we do is go to the debt capital markets. That's all comment right now.
Operator:	Mr. Jokisaari, is your question answered?
Taito Jokisaari:	Yes, just a follow-up that do you have any thoughts yet how big share the debt markets of this 3 billion could be?
Margus Kaasik:	Well it is rather difficult to say anything about what we exactly will acquire from debt markets as we still have other debt sources available as well, from the banks for instance and I think it is rather early to say that we definitely have some debt metrics that we keep in mind to keep debt levels reasonable and our ratings reasonable and that's what we do follow and I think that gives the best guidance for the possible debt levels could be.
Taito Jokisaari	Thank you.
Operator:	Ladies and gentlemen, as a reminder if you have questions please press *1. Thank you. Excuse me Mr. Kaasik, there are no questions at this time.
Margus Kaasik:	Thank you. Then from our end…
Operator:	Excuse me for interrupt you, Mr. Kaasik…|
Margus Kaasik:	that is all we have.
Operator:	there is question from Emmanuel Teissier from Franklin Templeton. Please go ahead Sir. Mr. Teissier?
Emmanuel Teissier:	Yes, sorry. Good morning, first all. Thank you very much for that call, I have a question regarding your request to increase tariff in Estonia. I've read recently that your request has been withdrawn and I would like to know if you could explain what would be the negative impact on profitability regarding that withdrawal. Given the inflation in Estonia at around 4 percent, I'm sure that will have some pressure on your margin so if you can clarify that for me.
Margus Kaasik:	Yes we can, of course. Yes, the distribution tariff increase is postponed somewhat. We had a long discussion with our regulator that didn't end for us too favourably and then we wanted to, we all decided to withdraw that application and start with a new one. Yes, the tariff increase will follow at one point of time earliest being sometime mid 2011 but it could be later as well. It does affect our profitability, but what I could say is that well the tariff increase first of all was supposed to cover some pass-through elements of the cost and those pass-through elements will be anyway compensated also if the price increase comes a bit later so that does not affect our bottom line in the end. Then there was an element that we wanted to increase the regulated return, so that means that if we don't get that increase in regulated return, returns will remain the same, but we did want to increase them. Of course there is some element of change in cost but actually the changes in the cost side are not significant. The other price driver actually was the investment side we wanted to increase significantly the investment in the distribution network that would increase tariffs, but as the tariff increase is now a bit postponed, we do postpone the investments as well, so the pressure from the investment side or the regulated asset-based side is also lower. All in all, what we can say that we did expect to get to distribution network additional roughly €20 million per annum that we are now missing, but as I said part of it would have been increase in the return side. The other significant part would have been to cover the increase in regulated asset-base that now will also be lower or postponed. On the bottom line of distribution network the effect is not that significant. We don't expect to lose much on the return side. As you saw the return side is currently is 6.5 percent and it actually shouldn't decrease significantly over the next few quarters. It should remain almost the same being about 6 percent or above that.
Emmanuel Teissier:	Alright, thank you very much.
Operator:	Excuse me, Mr. Kaasik there are no more questions at this time.
Margus Kaasik:	If there are no further questions then also thank you from our side for you listening to us to explaining our results and it was the first time that we did that conference call and that definitely won't be the last time. Let's keep in touch also during the next quarter calls. Thank you.
Operator:	Ladies and gentlemen thank you for joining and have a pleasant day. Good-bye.