Eesti Engeria "Release Q1 2012 financial results" Conference Call

MODERATORS:
MR. MARGUS KAASIK, CFO

Margus Kaasik: Hello, I am Margus Kaasik, CFO of Eesti Energia and I will be walking you through our quarterly results this time. Just a little apology from our side, we had some technical issues on uploading our presentation for that particular call into our website, it should be at least now up and running there, so if you have not been able to open the presentation before, then you are kindly asked to do it now because now you should be able to do it. But I hope that you have now been able to open it and I will start on page 3that is just giving an overview of our results. What we can see is that we have stable revenues this quarter. Our revenues were down half a percent and basically similar to what they were a year ago. On the profit side, on both EBIT and EBITDA we got an healthy increase, EBIT grow about 28 percent. We had a decline in operating cash flow side and increase in CAPEX. But I will come to those changes and reasons for such changes in later presentation.

Now, on the next slide a quick market update on slide 4. The last quarter was quite something I would say. If we look at it at various angles it was quite different from what it was a year ago. One thing that we did note is that most of the time, Estonian and Finish prices were equal and on average, they were pretty much the same. Although sometimes and especially in the beginning of the quarter, Finish prices were higher than Estonian ones and later in the quarter actually, it was vice versa that prices in Finland and also system prices were quite depressed. But prices in Estonian area were quite okay.

What for us is extremely important is that despite the quite low level of our prices on power exchange, the clean dark spread that we are getting is good and is even much better than it was a year ago. If you look then on average against that spot price, we were able to get EUR20 per MWh hour out, so that is a significant spread to get for a power plant. Now on slide 5 the revenue breakdown. As I said in the beginning, our revenues were basically flat compared to last year's first quarter. We did exhibit increases with several products and most importantly with network services and oil sales but we had - but this was basically an offset by the decline in the power sales of our generation as well.

Now, back to slide 6 we come to our different products and first our regulated market. There are basically no news, the volumes have been quite stable. Basically economic growth should increase the consumption somewhat but then again, there was quite warm weather last quarter, so that did off-set this economic growth effect so the sales were pretty flat. And also from the revenue's angle as the prices were basically the same as they were a year ago then the revenues also stayed quite flat. And there are still nine months to go on the regulated market and from the next year, we expect markets to be fully open.

In the unregulated market side, currently we do have market shares in all the Baltic unregulated market of 21 percent and basically, if you look at the sales with unregulated prices, then here's the decline that we indicated in the power side, and it came mostly from the sales to wholesale market or power exchange. On the retail side we did increase our retail sales by 73 GWh but we had a drastic decline on the wholesale side. The main reason for that decline was that from this year we have a cap on our emissions so our output from our power plants is about 10 percent less than it was a year ago and therefore, what we have done is that we have set a bit higher minimum margin that we want to earn from our spot sales and therefore, during the last quarter prices were pretty volatile and there was some time where this margin target was not met and then we did not generate as much during the last quarter. We do expect that the margins are even better later this year and we will use that possibility to generate fully by the end of this year. On that pricing side, the price that we got from our power sales was EUR52 per MWh; it is up about 7 percent, so we are doing very well on the market. And if you look at the spot market prices, then these are somewhat lower. We have been able to secure ourselves through retail sales, through different hedging instruments. A much better price than most seen on the spot market.

Again, we have also good news on the renewable side, we had increased renewable generation and our subsidies from renewable energy is up 182 percent so EUR9 million we got subsidies for renewable power. Most - the increase came mostly from Biomass co-firing in one of our power plants in Narva and in one of those units where we use the biomass, we basically did use close to 50 percent biomass alongside to oil shale.

On slide 8, the network side, the volumes are pretty much flat to the last year. They're told that the weather is the main culprit here, but revenues have increased quite steeply and there are two main reasons for the tariffs on network services from last August that did increased significantly our margin on network services. And we also had a smaller tariff correction from 1 January, but that was mainly due to transmission price increases and that is the part that is relevant. So from that increase we did not gain anything.

Slide 9 on the oil front. We got 50 percent higher revenues than we did last year during that first quarter and it was due to the fact that we sold more and we sold more 25 percent oil and also the prices have still been climbing up and up and that also did increase our revenues significantly. The average price that we got for our product after all the hedging transactions is EUR406 per ton. Basically the spot rate itself was EUR500 per ton. Decent prices we got for our product.

Slide 10 other revenues. Here basically I would point out two facts. First most important is that we sold our telecommunication business and that did give us additional profit from the sale close to EUR14 million and that did have significant impacts on our whole revenue and even more so to our profit. And then second point to mention here is the decline in the sales of heat and this is due -- first due to the sale of one district heating company during last year and so we do not have it anymore. And secondly we did also produce less heat also in the Tallinn area as the demand for our power plant has decreased somewhat.

Now, slide 11 about the OPEX. On the OPEX front mainly good news. As our generation volumes have dropped, so also have dropped the cost levels and basically EUR90 million is the OPEX reduction due to lower sale volumes. On the pricing side or the price of inputs side, news are pretty good as there is little pressure from input prices mainly because CO2 has dropped so much and it as upset the other growth, for instance, on the pure side and on the higher network fee side. Fixed costs are well under control, they did not change until last quarter and depreciation has risen also moderately.

Slide 12 our EBIT breakdown and EBIT has grown from 44 to EUR56 million. Most of this growth or basically we can say the biggest part of the growth has come from the retail side. From that 20, basically 14 is one-off growth or one-off profit that we got from sales of our telecommunications business. The other bit is from higher sales margins. One thing to note also here is that now from this year onwards we are reporting distribution network as a separate business segment it was last year and the year before reported as part of the retail segment but now the retail side includes only retail power operations and distribution is a separate business. And by the way talking about distribution and their contribution to EBIT growth was EUR5 million, that's mainly from the tariffs that they got last year. In the electricity and heat generation side, the decline was EUR12 million and that was mainly because heat generation was a bit held back and that mainly caused the lower EBIT. Fuel’s results did not impact the EBIT at this quarter or the change of EBIT this quarter at the oil side did go up, we have got definitely a lot more revenues and profits from the oil sales but it was offset by decline of profits in the mining area.

Okay, but now we have a bit more detail on our different business segments profitability. First, page 13 is retail side; as I said two items there already first is sale of the telecommunication business that did contribute EUR14 million and about EUR7 million was the contribution from higher sales margins. Perhaps one thing to add here about those margins is that, again, from this year we have a bit changed the way we operate internally and last year retail business hedged internally all the sales in the unregulated market. And then on the back of those hedges got basically their margin, now from this year we run retail business unhedged. Basically what it is naturally hedged that we generate power but as a separate business it is unhedged basically just buying from the spot price, the spot market and the spot price risk is evident that the spot prices were quite favourable during the first quarter of 2012 and also that did contribute significantly to the margins.

Slide 14, the distribution network, there the main driver for profit growth definitely is an increase in network tariffs and the effect of those were close to EUR8 million and then there are some defects that are driving it somewhat down. The increases in fixed expenses or repairing expenses or depreciation are those that are a bit eroding the growth of the network tariffs.

Slide 15, on the generation front, as I indicated the decline in EBIT was EUR12 million. Most of it or basically close to EUR10 million was due to our lower sales volumes but we would expect to regain those later during this year. They had positive effects on generation business had positive effects from lower retail expenses as we told during last year's calls that last year we did some so-called extraordinary maintenance or did some maintenance ahead because we had FDG's put onto our power plants and we used the time also to do a bit general overhauls and because of that, now we can run those units with far less repair expenses. And also an important impact was from the decrease in heat sales. As you already saw from other revenues that heat sales was down significantly and that decline also did have an effect also on our EBIT.

Slide 16, oil business, it's the fuel division. And basically, the fuel division stayed flat but it did stay flat in the circumstances where we got significantly more out of the oil business. The oil volumes did give additional EUR3.6 million and increased prices about EUR3 million so, altogether, basically close to EUR7 million came from increased oil prices. But it was to a large extent offset by the declining profitability of mining subsidiary and the next slide 17 is the profitability breakdown of our mining business. They did have a bit higher sales margin during the last quarter, but still the lower sales volumes because of lower demand from our generation side, did significantly decrease the profit in the mining side.

Now, on page 18 we have basically combined on a group level all those different effects on our profitability and here we can see that on the consolidated basis the growth in our EBIT was driven mainly by non-recurring revenues from sales of business we did sell telecommunication business this year and district heating companye last year. There was sales - the net effect of those sales for profit change is EUR11 million. Higher margins on network services gave EUR8 million and higher profitability of oil sales gave EUR7 million. So these are the most important positive effects. On the negative side, most importantly was the effect of lower sales volumes in the generation side and that did take basically EUR11 million and then higher depreciation and lower profitability on the heat-side also basically. Both took about EUR3 million.

Now, turning to cash flows and we indicated on the first slide the cash flow did not look that good than it did the year before. On the slide 19 there is a breakdown from EBITDA to our operating cash flow, then things look pretty regular in a sense that from that EBITDA we have to subtract basically the profits that we have posted from sale of telecom as the cash flows are classified as investment cash flows. Then we have increase, a slight increase in the receivables side and in the inventories. Inventories increase was mainly because as I said, generation was down and then we did fill up our inventories with oil shale to keep our mining operations running efficiently. And then there was some little contribution from provision and these provisions are mainly provisions for CO2 that we have basically used during our power generation during the first quarter but have not yet bought, we will buy that CO2 at the end of this year. So that is how we get to this basically EUR16 million of operated cash flow.

On the next slide there is also a comparison to last year, so how come the cash flows have decreased from 105 to 59 and few things stand out here which I will perhaps comment on a bit more. One is higher trade receivables and payables and during the last year we had very successful collection, we got much more out of our clients and partners, and therefore, the flows on that end were much better now than we have also higher sales and that has driven the trade receivables up to some extent. Compared to last year, it has retained EUR18 million of cash. Second and important thing to comment is CO2 provisions, last year during the first quarter our provisions for CO2 were much much higher provisions for costs that was not yet paid out and that did increase the cash flow significantly during last year's first quarter. But this year as we generated less and we also have more free allowances and would have lower allowance prices as well and the provisions are really marginal and did not contribute in any way for the first quarter's cash flow.

Now, turning to page 21, to CAPEX. The CAPEX were EUR129 million in the first quarter. It is very, very roughly basically that one quarter of the investments that we intend to do this year. Many of them - the biggest part of the investment went into this new power plant in Auvere very close to Narva and that is EUR64 million, the other investment projects were significantly smaller, division network EUR50 million for instance or oil share for our Enefit shale oil plant, EUR8 million.

Next slide, 22, here is the progress of our CAPEX programme. You can see what will have used up so far and what is the expected CAPEX and where we stand. There is some comments to most important projects the Enefit oil plant is basically a plant now being mechanically complete and commissioning is about to start. We do expect that already last quarter this year the Enefit new oil plant should contribute also to our revenues and profits. The desulphurisation equipment for our old power plant, that's mainly there already and is significantly reducing the sulphur emissions and helps us to be inside the limits that are imposed from this year. What we are doing there still is adding line injection lines to be able to drive emissions even further down than without that we could. Then we have a few wind investments here, Narva windpark is basically ready and the testing is going on to get grid acceptance and to get the renewable subsidies running. And what else; basically there is a power plant in Auvere that's where EUR133 million have gone already and the construction has started and does take a while before the power plant is ready. We will expect that the commissioning is starting some time during 2015.

On page 23 we have given some details about the sales of our telecommunication business and the effects that we have this year. As we said during first quarter we got profits from the sale of business of EUR14 million and the negative effect that we have over there reminder of the areas of last year, basically the telecommunication business did earn EUR4 million of EBIT and this year we are not getting EBIT from the telecommunication business anymore.

Now, we are on page 24, about our financial side and liquidity. On the liquidity side we look good, in a sense that we have enough liquidity lines available. We also have - we also issued EUR3 million bond at the beginning of April and as such our current cash balances and liquidity position in general looks very good. If you look at the net debt/EBITDA targets what we have set for ourselves, currently the levels are still modest by the end of first quarter 2012 the multiple was at 1.6 net debt/EBITDA. But it is growing, growing further.

Page 25, outlook for this year, as we have now closed the sale of telecommunication subsidiary then we have slightly updated the outlook and what we can see is that revenues should go up during - slightly during this year. We also expect to have a slight growth in the EBITDA side. On the EBIT side we expect the results to be more or less stable as also the depreciation costs are increasing quite a lot and some investments are already or becoming ready during this calendar year.

The summary on page 26, the summary says that we have revenues that were stable, they were stable despite the fact that we did generate significantly less than we did a year ago. EBITDA grew 24 percent significantly, also we have significant growth on the EBIT side. The profitability was mainly affected by the sales of telecommunication subsidiary. If we take that away then the growth in the profits were quite marginal but still, if we take into account the sales in our oil side and distribution network side were very good and we have a good potential in generation side for next nine months of this year then definitely we at least are content with results that we have been presenting. On the investment side, we did invest EUR129 million this quarter and on the financing side the most important thing was the new Euro bond that will secure the long-term financing for this CAPEX program.

Thank you from my end and definitely, if there are any questions, we are glad to answer.

Operator: We will now begin the question and answer session. Anyone who wishes to ask a question may press star and one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star and two. Participants are requested to use only handsets while asking the question. Anyone who has a question may press star and one at this time. As a reminder to ask a question; please press star and one. Excuse me, gentlemen, there are no questions.

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Margus Kaasik:	If there are no questions then we thank –
Operator:	Excuse me, we just - we have just had a question come in.
Margus Kaasik:	Oh good.
Operator:	I have a question from Lauren Millspauch from European Credit Management. Please, go ahead.
Lauren Millspauch:	Hi, how are you interfering to handle the liberisation of the market in 2013, the impact on your market share? Or just add some colour, I do not know if I missed that at the beginning of the call, but how are you planning to anticipate the impact?
Margus Kaasik:	Yes, basically we do not have a market opening from next year and the impact that we currently are expecting is still positive. It of course depends a lot what is the price level that we are able to get out of our customers in the end of this year for next year. But if we look at the current market prices, then we do see that the forward prices for next year for instance on the wholesale markets are roughly 44-45. The regulated prices that we are selling at is 30 so basically, we do at least in the current market environment see the uplift in the prices in the range of EUR15 per MWh. On the downside, we had to start buying in basically all the carbon credits that we still have got significantly, we got significant free allowances, but if we look at what the carbon credit currently stand for, it's basically roughly EUR7 per MWh, then between that up to EUR15 that we should have a price uplift and the carbon price we should still have a fairly decent margin for ourselves. But as I said, it's the current market situation and it may change over time and you can monitor it as well, how it evolves. But currently, we do expect to benefit. And regarding the market share. From the bit of the market that currently is open and for a lot of our customers it is open, we have been able to retain 70 percent roughly. From the other bit of the market that now is opening, it also includes households and small and medium companies and so on. Their client retention rate could be higher or the tendency for them to wander away may be lower. So, we may be able to retain a higher number of customers but, in the end, it's not from the bottom line point of view, it's not that important as the wholesale market is so deep, here, and so liquid that basically that price uplift will begin anyway if we are not selling at 45 to retail markets, we will sell it on the power wholesale market and liquidity and deepness of the market is absolutely sufficient to absorb it.
Lauren Millspauch:	Okay, thank you.
Margus Kaasik:	But currently, we do expect that we retain large market shares as well.
Lauren Millspauch:	Okay, so you are anticipating using the pricing to stay competitive I guess?
Margus Kaasik:	Yes.
Lauren Millspauch:	Okay. And so you are just safely, as far as the carbon issue comes into play and how you stay competitive in the Nord Pool markets?
Margus Kaasik:	Well, on the carbon side I think that is the biggest impact on our business potentially as the carbon footprint in our generation is quite significant and averages roughly about 1 ton per MWh. So, that is not little but still, if we look how we are doing now or how we did for instance a year ago when the carbon credits did cost significantly more than our clean dark spreads are still very decent. And that is mainly because the price of our fuel, oil shale is still very very much competitive. For instance, if you compare it to gas or coal bio generation then the fuel costs in these power plants are much, much higher than we have. For instance, in our power plant currently the fuel cost itself is something like EUR15 per MWh, compare it to what it is on the coal or gas side, it's much, much higher. So because of that low fuel costs, we do expect that our competitiveness in the market will remain for even somewhat higher carbon prices as they are today.
Lauren Millspauch:	Okay, that helps, yes. Okay. That is it from me, thanks.
Margus Kaasik:	Okay, thanks.
Operator:	The next question comes from Uli Gerhard from Insight Investment. Please go ahead, sir.
Uli Gerhard:	Good morning. Yes, I was wondering; you sold your telecommunication business, probably you want to streamline the operation a bit but, you know, you sold it basically for two-times cash flow? Any reason, you know, for that kind of multiple? And then, I was wondering if you would comment a bit about first of all the accords by Lithuania and Hitachi regarding the nuclear power plant, oil shale development in Serbia. And also, is there a point where you might actually want to add to carbon credits given where the valuations are?
Margus Kaasik	Now, that was plenty of questions but let us start from the beginning. You are kindly asked to remind me what the next one was, but I definitely remember the first one and that was the sales of the telecomm business. Well, it actually did not look that bad as you told does now. If we look at the sustainable EBITDA that the telecomm business is able to generate by our forecasts, then we basically sold it at close to five times sustainable EBITDA.

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What the issue there is that we have quite a substantial part of this EBITDA came from basically wireless Internet business that we set up a few years ago and which is let us say, starting to struggle in the market and most likely will be taken off the market quite soon. I mean next one or two years most likely and then, if you just look at the broadband business like the rest of that business in our telecommunication business plan, then comparing to sustainable EBITDA we have a fairly okay deal.

Uli Gerhard: Okay

Margus Kaasik And then secondly what is even perhaps more important is that the broadband business that we are basically selling or sold, that is most basically broadband business, it was done on the back of the lease agreement, lease agreement of optical cables and that was only ten years' lease that we had left. So the lifetime of the assets that the business was based on was also limited. So, all in all, at least we were quite content what we got out of the deal.

Uli Gerhard: Okay

Margus Kaasik: So then the next question was - what was the next one?

Uli Gerhard: Nuclear plant, nuclear plant.

Margus Kaasik: Nuclear plant. Well, now nuclear plant is something that Lithuanians are intending to build in Lithuania we have put the project together. We are looking that closely, we haven't joined officially yet, are not covering any costs yet and as it stands now, we most likely are not starting to be an official part of the project in the next few years, but we will see. But at least currently, the Lithuanians are still doing this pre-development work there. They may succeed with that, they may not, I think it does look rather gloomy and we are not very unhappy about it.

Uli Gerhard: Okay

Margus Kaasik: The second question or the third one was about Serbia, I think it was Serbia. And Serbia is the place where we could sell our oil shale, oil technology. They are doing some investigations and something with their reserves, they are intending to develop them. We are looking closely what they are doing and may also consider at one point of time doing some sort of cooperation in Serbia with our technology definitely. The oil shale reserves that they have are very decent, at least what we know and it may have potential to use our technology.

Uli Gerhard: And you probably are the more tenable partner than the other party mentioned; I would assume given history?

Margus Kaasik: Most likely, yes. Most likely. Then we had question about CO_2 and whether we would like to be a bit less short or more wrong with CO_2 now because of the prices. And that is exactly what we have been doing, we actually have been building up a position of CO_2 ourselves. To some extent, using just forwards to buy forward CO_2 and we also have used options to buy CO_2. So, we are, you know, also considering the current situation quite good for us and the price is very, very good.

Uli Gerhard: It extends your lifetime with your plants; right?

Margus Kaasik: Exactly, exactly, and therefore, we have been building a little - the position that could help us in the future potentially.

Uli Gerhard: And how much money do you think you might put into this?

Margus Kaasik: On the option side I think we - if I recall correctly, I think we did use EUR10 million to EUR15 million to buy call options in 2010 to 2013. And for that I think we got options for 10 million tons something like that. We can elaborate it more with our next interim report but that is interesting.

Uli Gerhard: Okay, fine, thank you very much.

Margus Kaasik: Thank you.

Operator: As a reminder; if you would like to ask a question, please press star and one on your telephone. Gentlemen, we have no more questions.

Margus Kaasik: Well, then I thank you again for joining. I thank you for the questions and being interested in our business and definitely I am glad to host you so in three months' time when we are talking about our second quarter results. And we have all the information in the web for the presentation, the interim report, the call, transcript and so on, so definitely, you are also very welcome to visit our website or contact us in any other way. Thank you.