Eesti Energia

Eesti Energia Q1 Results 2014 Conference Call

Speaker:
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Veiko Räim: Hi. Good Morning. I am very happy to be here and present to you the first quarter results of Eesti Energia. And obviously, if you have any questions, then we can take them thereafter.

In a snapshot, if you move to page number three of the presentation that you hopefully have found from our investor relations website, then essentially it was a positive quarter. We had EBITDA which was 14 percent higher than last year, up to EUR83 million. Revenues did come short compared to last year at minus 19 percent. And cash flow from operations as well as investments also were a bit over last year's numbers. So we shall discuss these items all in turn.
So if we move now to page number four and firstly take a look on the regional power market, then obviously the prices have drifted lower this quarter. And if we see our main proxy, the Nord Pool Spot Estonian price here – our price was EUR35.8 in this quarter which is 15 percent lower than a year ago – then obviously it does not help us as a power producer. On the other hand, on a more positive note, if you look at the graph on the bottom left-hand side on page four, then you'll see that the dark green bar has been increasing this means is that the integration between Estonia and Finnish power markets is growing. Estlink2 started operations in essentially end of last year and actually it has been quite a bit more operational already after going through the commissioning in the first quarter this year. So you can see the impact there being that 89 percent of the hours in the quarter, actually there the prices were equal. So 11 percent of the hours, Estonian price was higher than Finnish price but, you know, it's actually a very good ratio.

Now, on the right hand side, we actually show the clean dark spread development of Eesti Energia. And we have changed the presentation somewhat. So we've shown here the previous way how we described this and the new way, so to speak. So previously we showed only the clean dark spread with the mining variable costs, whereas now we have shown also here the orange line, the spread our power generation earns in case we take the full mining cost into account. The new way, we believe is more comparable with the clean dark spreads of the European utilities that one looks at. So in that sense we hope this will improve the comparability.

And obviously, as the power prices have been lower, then also our spreads have dropped. We have sort of had the situation, the mark, that the clean dark spread reached EUR12 in the first quarter of 2014. It is less than before, even though it's somewhat comparable with the 2012 numbers. But obviously it is still a reasonable level compared to the European gas and coal producers, which sometimes have quite a bit lower spread to cover their fixed costs. So hopefully this is all clear as we present.

Moving on, on page number five, the Estonia Latvia electricity price spread - we have plotted. This has become especially valid since last year when the new system was established on the Estonia-Latvia border. So in the first quarter, the price difference on average has been EUR6.6 per megawatt hour. It is less than the full year last year so that's definitely good news, because obviously we are exposed in such manner that if the price difference gets very big then we sell our generation in Estonia and as we have to purchase power in Latvia to service our signed fixed contracts then obviously there is a price difference we need to pay. So as you see in the last quarter than in the first quarter. I mean, obviously, we do revalue our portfolio and in this quarter we had positive impact of EUR6 million. But obviously that just means that the power portfolio that we revalue, expectations on the price difference have changed compared to last year when we made the previous revaluation. So all in all, we have 1.9 terawatt hours of power sold forward as of 31st of March in 2014 and that actually mostly covers 2014 and 15 years to Latvian and Lithuanian clients.
So if we move on, page number six. Speak a bit about oil now. Not really many good news on this slide, as you do see then, both the crude oil price, the Brent as well as the fuel oil price, which is the reference product for our shale oil sales – have both been trending lower throughout the quarters. So last quarter the level of fuel oil price, the reference product, was around EUR445 which is about 7 percent lower than a year ago. And it is really the lack of demand that we do see that is affecting the Brent and the fuel oil alike. The only positive, if one wants to find on this page, is really that essentially the crack spread between the fuel oil and Brent –was slightly lower in the first quarter of 2014 compared to the second half of last year at EUR8.8 per tonne, sorry, barrel. But it is still above the levels that we saw the first half of 2013. So not much benefit from crack either.

Good. Now that we've covered the market, the environment has been challenging, reasonably, in the first quarter of 2014. So I guess the next reasonable question to ask is how have we fared? And if you turn to page number seven, where we plot our sales and EBITDA development, then you do see that revenues were lower than last year by 19 percent and essentially lower for all main products categories that they have – electricity, distribution and shale oil. But especially they were lower in electricity and we'll discuss that in a moment.

On EBITDA front though, while power revenues were lower, then still we managed to earn better EBITDA than last year. And even though distribution and shale oil were slightly lower then the other products came in again higher. So we shall look into these products all in turn.

So, without further ado, let's go to page number eight, electricity sales. One main reason for lower sales revenues on the electricity side was really the almost three times lower sale on wholesale market. We did sell a bit less in the retail market as well. We'll discuss the changes in market shares on the next page. But on the wholesale market, eventually as the price level was substantially lower – 15 percent less than last year – then our power generation portfolio was just generating much less. So that is the main culprit. On a positive note, obviously we do hedge our risks inherent in our power generation portfolio. And we actually earned, mainly thanks to that, higher average electricity sales price. For every power megawatt that we sold, we earned EUR49.8 and essentially if the financial hedges were taken away, then obviously that would have been less than last year. But right now, we did see almost 9.9 percent higher, power price for our sales. And I think here it's also worthwhile to note that in second, third and fourth quarter we have also hedged our power generation portfolio in combined value of 6.8 terawatt hours. The average price of these hedges is EUR43.1 per megawatt hour. So if the prices stay as they are, as they were in the first quarter, then these hedges will help us as well. In the 2015 obviously the hedging level is lower. It is at 5.7 terawatt hours, we'll have a price of EUR39.6 per megawatt hour. But this we expect to increase as we go through the year.

Turn now to page number nine. Then there we have plotted the retail market developments. And there we essentially have lost a bit of market share in Estonia – 11 percentage points less. And mainly it is due to the movement in the larger, corporate client segments. So it is a volatile segment in a sense that they are most price sensitive. So I think, gaining it back will be easy if we want to reduce prices. But obviously we also want to earn a margin. So there we've lost the market share and we currently hold in the first quarter a 60 percent of Estonian total electricity market. In Latvia and Lithuania, it is also worthwhile noting that we haven't signed new fixed price electricity sales agreements since September 2013 which means that obviously we are more losing clients than gaining clients, given that the fixed price agreement is still the norm in the market. We have sold a bit of floating price and will continue to do that. But as discussed earlier, currently the hedging of the Latvia-Estonia border risk isn't available to such an extent to merit our continued retail sales operations in Latvia and Lithuania. So we are not selling with fixed price and, as a result, obviously, our market share is bound to decline. It is not yet evident in the first quarter that much, obviously, as we compare on the beginning of last year. But in Latvia we have a 15 percent of the market in Q1 and in Lithuania 6 percent market in Q1. Which in total means that we have approximately 27 percent of the Baltic total power market supplied by our supply business.

Good. We have covered electricity sales and market shares. Now let's move to EBITDA on page 10. So how did we manage despite lower sales to increase the profitability here? Obviously there was a negative impact from lower volumes sold, EUR16 million. We counted that as our sales volume decreased by 35 percent. But it was more than made up by three or four positive developments. And the margin, actually, if we even take away the financial hedges, then still there is a positive margin effect, mainly due to higher subsidies and actually lower CO_2 costs. So obviously we did pay for border crossing in Latvia and Lithuania for about EUR2.5 million. But if you take the main margin impacts together, then actually we earned EUR4 million higher margin in 2014 compared to last year.

Regarding volume impact, I discussed. Change of fixed expenses obviously has helped and I think saving of fixed expenses will be the norm in this Group going forward, economising on the fixed costs. Financial hedges, as noted, obviously helped us a lot in this quarter. We improved our EBITDA by EUR12 million due to financial hedges. So we're happy that we had them. And finally, the revaluation of the Latvia and Lithuania energy sales portfolio comes in as other impact, that's just over EUR6 million, which also improved the electricity EBITDA. That's more of a transitory nature. Obviously it will continue – the revaluations will continue – until the end of the portfolio at the end of 2015.

Right. When we now turn to distribution on page 11, then obviously part of the reason why our power prices have been lower in Nord Pool Spot Estonia region was the warmer weather and that has also impacted us on our distribution business side. The volume of distributed power actually dropped by 4.5 percent to 1.8 terawatt hours of power in the first quarter of 2014 and that brought about also the reduction in sales revenue by 3 percent to EUR67.9 million. Distribution tariff wasn't much higher so that's compared to the same period last year. So that helped to, sort of, reduce the sales reduction, if you will. But obviously the volume impact was large in this case. What we also note here is that the network losses were higher in the first quarter by five gigawatt hours. And, obviously, that's 0.5 percentage points if you want to discuss it in percentage points. So that, we will obviously need to keep a good eye on.

Good. If we go to distribution profitability on page number 12, then it is worthwhile to note that while the losses were higher, the cost of distribution losses was lower and that was due to the lower wholesale market power price in Nord Pool. Obviously there was a much higher average sales price as well. So all together, we had a margin impact on profitability even on EUR2 million. On the other hand, lower volume of sales reduced EBITDA as did, sort of, higher fixed expenses. So all in all, we had about 2 percent lower EBITDA from our distribution product at EUR21.8 million in the first quarter of 2014.

Right, moving on to oil as our third main product, on page number 13. So the shale oil revenues were quite substantially lower in this quarter and it was to do both with volume impact and price impact. So if we discuss the volume side first, then on a positive note, the production levels were higher – 15 percent at 61,900 tonnes in this quarter. So that is good. On the other hand, sales was substantially lower than last year at the same time. And the main reason there is the changes in oil specification of our product. We are working with the fixes on the equipment and expect to resolve these issues shortly and expect to be able to sell the produced oil as well in the coming quarters. But I think this quarter, obviously, you can see the impact has been quite substantial.

On the price side, we obviously earned a lower price by 15 percent. For every tonne of shale oil that we sold, we got EUR386. It is more pronounced as a drop in the heavy fuel oil price in the markets but it is to do also with the hedges. As the hedges were still slightly marked to market negatively, then obviously that was distributed on a quite small volume which thus dropped average sales price quite substantially.

Right. If we discuss the hedging further then obviously we have hedges for 130,000 tonnes for the Q2 to Q4 in 2014 and on a 92,000 tonnes in 2015, both with actually higher market price than was prevailing in this quarter.

Good. On the shale oil profitability, obviously, as the sale has been quite a bit lower, then that has impacted. EUR6.1 million is the volume impact on profitability. So that's the negative side. On the positive front, obviously some fixed expenses have been lower in this quarter. Also the CO2 costs have been lower in this quarter. And obviously there has been impact from revaluation of derivative instruments as well which in this quarter has been positive. So all in all, we have earned EUR3 million less this quarter from shale oil on EBITDA level and that comes in at EUR10.2 million of EBITDA in this quarter.

So, if we turn to page number 15 and discuss our other sales, then they're having quite a few bits of good news, especially from the revenues from heat sales. These were the main reasons for a 7 percent increase in revenues. And also, this has helped EBITDA quite substantially, as municipal waste-produced heat together with gate fees has helped both revenues and EBITDA.

On oil shale, revenues have remained reasonably flat. Volumes have decreased but their profitability has actually improved by EUR2 million. So all in all, if we take these impacts together and the other products' impact – what we earned in 2013 from the sales of fixed assets hasn't been met – then the total impact is still a positive by EUR2.5 million. And we earned EUR7.2 million of EBITDA from other products in the first quarter.

Good. And actually that increase, which was EUR2.6 million almost made up for the, sort of, drop in distribution and oil EBITDA, or at least made a substantial part of it.

Right. Now, if we turn from EBITDA to cash. And on page number 16, there we discuss it more. And obviously it is natural to ask why did we not generate more cash than last year in case we have high EBITDA. And I think the main reason really here is that we did use this cash to pre-purchase certain CO2 quotas out. We had to bring it forward CO2 to purchases actually and that impact was main in having the CO2 influencing the cash flow for operations from around EUR25 million. We did, in the quarter, have higher inventory of oil shale and shale oil as well as reduce our receivables, which was a positive impact. So these, you know, in combination balanced the reduction, or had a positive impact on the total operating cash flow. Another negative impact was from corporate income tax payables. In Estonia, the corporate income tax is payable after you distribute the dividends. We distributed dividends in December last year so we paid corporate income tax in January this year. So that had an impact on cash flow as well. So all in all, we earned EUR56.2 million cash from operations. And if we now look at page 17, and try compare it to last year's result, then mostly there are similar influencers here. First of all, the EBITDA change was positive, obviously. On the other hand, the CO2 purchases, pre-purchases, we didn't do in such an extent last year. And therefore, this has resulted in cash flow outflow. And obviously, similarly, the change in inventories has drawn on our cash this year whereas change in receivables has helped our cash position this year compared to the last. All in all, EUR12 million less cash flow than last year but definitely there is a good reason for pre-purchasing CO2 as long as the interest earned on the cash spent, is reasonable.

Good. Then if we turn to the investments on page number 18, then capital expenditure was EUR74 million, about the same as last year. Mainly two products, or mainly two projects here. Obviously Auvere Power Plant continues to be constructed. We have spent EUR34 million on this project this year, in the first quarter. We expect this to be on time and on schedule, currently. And we expect to see the commissioning starting later on this year and the plant become available, sort of, late 2015 still.

As for the electricity network investments, essentially distribution network investments that we undertook, EUR21 million, I'm sorry, in this quarter. And most of the other investments actually are of maintenance nature. There was one new project – sort of second phase on a new project started in this quarter – of denitrification or DeNOx, installing DeNOx equipment in Narva Power Plants. or rather Eesti Power Plant as a facility. And these are to be installed on four generator units which, all in total, have a net capacity of 672 megawatts which will allow these units to remain operational after 2015. These are the same units where we installed desulfurization equipment and essentially both of the desulfurization and DeNOx equipments are required to meet the environmental guidelines from 2016 onwards.

So, all in all, this project is 28 million, much smaller than the previous projects that we've shown. But we will be tracking this project going forward on this page.

Going on to page number 19, very small update on Enefit280 oil plant. We believe we've been successful in the first quarter. We have seen the, sort of, continuing operating runs of the plant. There are a few problems still to sort out – mainly the ash particle distribution plant ash balance which you'll see denoted on this big chart at number one on page number 19. And there are a few mechanical issues still to be resolved which altogether, in combination, mean that we cannot yet go to higher levels of capacity usage before these have been done. And the improvements on both of these fields are expected to take place in July-August, so we'll continue to operate the plant or do the operating runs at lower capacity usage before that time. And thereafter we expect to be able to ramp up the capacity usage to higher levels.

So the quality of the produced oil has been good and oil yield actually at 11.6 percent which means that for every one tonne of oil shale that you put into the machine, 0.116 tonnes of oil comes out. That actually is also according to expectations, so that's all good.

On the liquidity side, on page number 20, buffers are sufficient. We have EUR175 million of liquid assets as at end of the quarter and also EUR250 million of loans that we can draw on, both revolving credit facilities as well as investment loans from EIB. So altogether, EUR425 million of liquidity available and obviously we also did a transaction, a fund transaction, early in Q1 for an additional EUR100 million in nominal value, which obviously is reflected in the liquid assets right as at end of the quarter.

Now, if we go to the debt maturities profile, page number 21, then there you can see that we increased the Eurobond which is due in 2018. It is at EUR400 million and obviously the other Eurobond we have due in 2020. So that's EUR300 million. All in all, these are the main maturities. We shall pay very little back in this year and next year. And from 2016, one EIB loan starts amortising back. So essentially that's the EUR19 million that will be paid in 2016/17.

On the rating front we have still both stable outlooks for BBB+ from S&P and Baa2 from Moody's. And the net debt/EBITDA has also remained at 2.4 times. So essentially unchanged picture compared to the yearend.

On the outlook, page number 22, there we have thought long and hard about our best quarter results and decided to reduce our sales revenues outlook. Previously it was to be stable compared to 2013. But now, as we have seen a substantially lower Q1 as well as no material improvement in market prices for Q2 to Q4, then our current expectation is that our sales revenues in 2014 will fall below the 2013 result.

On the other hand, on EBITDA side, we keep an unchanged outlook that we earn roughly similar EBITDA this year compared to the last year. And on the investment front also, we do expect to see a quite substantial decrease in this year compared to the last year. So there we haven't seen any change in outlook either. Also, the dividend payment to sole shareholder will increase this year to EUR113.6 million. Income tax obviously levied on top of that is another EUR30 million. So that's the most we are expected to pay to our owner for the last year's result.

Finally, we have a summary here on page 23. So what one would need to take away from this quarter. Sales revenues – substantially lower, mainly due to the electricity sales and especially the wholesale side of the sales, the bulk price being lower in the wholesale market. Fuel sales was obviously also lower due to lower sales volume and price. On the EBITDA front thought there was electricity EBITDA did not suffer. On the contrary, it actually increased due to the huge financial hedges that we had in place. Also higher subsidies and lower CO2 costs and the reversal of Latvia and Lithuania power portfolio played its role. On the other positive notes on the EBITDA side, our heat and oil shale sales helped to actually support the group's EBITDA growth by EUR8 million. Finally, the investments remain on the same level and we obviously expect to see also lower investments going forward.

Great. I think by this, we have completed the presentation. There are a few appendices as well. If you have a look at these as well. And now I'm ready to take any questions that you may have.

Operator: Ladies and gentlemen, at this time we will begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star followed by two. If you are using speaker equipment today, please lift your handset before making your selections. Anyone who has a question may press star followed by one at this time. One moment for the first question please. This is your opportunity to ask your questions. If you'd like to ask a question, please press star followed by one. Excuse me, we have no questions.

Veiko Räim Right. But then I thank you very much for everybody who is listening to this broadcast. And obviously if you have any questions later on, then we remain happily in your disposal. Send us an email and or drop us a call. And obviously we will be back at the end of July for our second quarter results review. Thank you very much.