Eesti Energia Q1 2017 Results Conference Call

Speaker:
Andri Avila, CFO

Andri Avila:

Dear investors, dear partners. My name is Andri Avila, the CFO of Eesti Energia. Thank you for joining the conference call introducing Eesti Energia's first quarter 2017 financial results. You can access the presentation that we will go through during the call, at Eesti Energia website.

On slide 3 you can see a summary overview of Eesti Energia's first quarter results. It can be seen that we had a good first quarter this year, with sales revenues growing by 9% and EBITDA by 43% to 86 million euros. The improvement in EBITDA was based on all three major business segments and was also supported by the financial close of the Jordan electricity project which contributed 9 million euros to our first quarter EBITDA. We had a very strong quarter in terms of operating cash flow which more than tripled compared to the same period in 2016 and amounted to 132 million euros. Eesti Energia's investments have been in decline over the past couple of years and this trend continued. The amount of investments totalled 26 million euros, down by 18% from last year.

Next let's have a look at the developments that took place on our major commodity markets. On slide 4 you can see electricity price movements. In the first quarter of 2017 we witnessed almost equal power price in Estonia and Finland. The Estonian price equalled 32.8 euros per MWh, which is a 3% increase compared to the first quarter of 2016. The price spread between Estonia and Latvia was also at a very low level of 1 euro per MWh with Latvian price being higher than Estonian. The spread between these two countries has been decreasing owing to the NordBalt power cable between Lithuania and Sweden which reduces the electricity deficit in Latvia and Lithuania. Eesti Energia's clean dark spread amounted to 9.7 EUR per MWh in the first quarter which is higher than in the equivalent period of last year due to lower CO_2 and oil shale cost and higher power price in Estonia.

On slide 5 it can be seen that oil prices were substantially higher in the first quarter of this year compared to the same period in 2016. The average price of 1% sulphur content fuel oil has more than doubled in euro terms from Q1 2016 and amounted to 278 euros per tonne. This is both due to higher price of Brent as well as the narrowing of the fuel oil crack spread which is beneficial for us.

Moving to slide 6, let's look at the breakdown of our sales revenues and EBITDA by business segment. Eesti Energia's revenues increased by 9% in the first quarter in year-on-year comparison and amounted to 215 million euros. The growth was supported by electricity and shale oil segment. Contribution from the Other segment was negative mainly due to lower heat sales volumes. Our EBITDA totalled 86 million euros in the first quarter, up by 43%. The growth rate was supported by improved market conditions for electricity and oil this year as well as 9.2 million euro contribution to EBITDA by the financial close of the Jordan power project.

Starting from slide 8, let's look at the results of each of our business segments in greater detail. Starting off with the electricity segment, it can be seen that our electricity sales volume grew by 20% to 2.7 TWh in the first quarter. The growth resulted from wholesale, while retail sales went through a small decline. Our electricity generation volumes increased by 29%, which is even more than our sales volume. Improved clean dark spread enabled us to produce higher quantities. Our average electricity sales price decreased by 6.5% to 39.9 euros per MWh. The decline in the sales price was moderated by gains from derivatives which contributed 2.4 euros per MWh to our average sales price. We had a relatively large share of our production hedged for the first quarter of this year and there is a remaining 2.7 TWh position of hedges for the rest of the quarters at an average price of 33.5 euros per MWh.
On slide 9 let's look at our retail market shares for electricity sales. Eesti Energia's combined market share in the Baltics totalled 26% in the first quarter of 2017, which is 0.7 percentage points lower compared to the same period of last year. In Estonia we had a minor increase in market share while we saw a small decline in Latvia and Lithuania.

On slide 10 let's look at the profitability development of the electricity segment. Our EBITDA from electricity segment amounted to 37 million euros in the first quarter, a substantial 44% increase from the year before. The most important driver behind this change was higher sales volume, which contributed around 9 million of the total increase. We also had a positive impact from margins. Although our average sales revenue decreased, our variable costs declined even more so the total margin impact was positive to the result in the amount of 3 million euros. Fixed costs had a small negative effect on electricity EBITDA. Gains from hedge positions contributed 4 million more compared to last year while revaluation of certain derivatives which are not part of hedge accounting had a negative impact. So to sum up, we had strong growth from the electricity segment in the first quarter compared to the same period last year.

Moving next to distribution segment on slide 12, it can be seen that distribution volumes declined by 1.4% in the first quarter owing to warmer weather. The average distribution sales price was slightly higher than in the first quarter of 2016 so in combination the sales revenue from the distribution segment declined by 1.1%. The average duration of unplanned interruptions, the so-called SAIDI index, amounted to a low level of 15 minutes in the first quarter which was the result of better weather conditions but also due to our continued investments in improving the quality of the grid.

Moving on to slide 13, it can be seen that despite a small decline in revenues, EBITDA from the distribution network improved by 2% in the first quarter. Lower sales volumes were more than compensated by lower fixed costs, lower variable costs and slightly higher average sales price. As a result, EBITDA from the distribution segment amounted to 29 million euros.

Next let's look at our third large business segment which is shale oil. On slide 15, it can be seen that our oil sales volume grew substantially in the first quarter. The same period in 2016 was characterised by very low prices which stopped us selling our product for a certain period of time. In the first quarter of this year, our sales amounted to 77 thousand tonnes, more than double compared to 2016. Our production volume also increased by more than half, as we changed our production and maintenance schedules last year to cope with low prices whereas we produce as much as we can with current prices. Our average oil sales price, including the impact of hedges, increased by 16%. Market prices have been increased substantially since the last year but the effect has been more moderate if we include the effect from hedges on our average price. In the first quarter of last year we still benefitted from old hedge positions that had been entered into at high price levels. This year the impact from hedges comes from new positions that we entered into in 2016 as we resumed our hedging programme after the market lows. Currently, market prices are higher than the price of our hedge positions so we had a small negative impact from hedge positions to our average price in the first quarter. All in all, the combination of higher sales volume and higher sales price translated into shale oil revenues of 18 million euros compared to just 7 million euros in the first quarter of 2016. In terms of hedge positions going forward, we have 215 thousand tonnes of our production hedges for the remaining quarters of 2017 at an average price of 238 euros per tonne, and 214 thousand tonnes hedged for 2018 at an average price of 255 euros per tonne.

On the following slide, slide number 16, you can see that our EBITDA from shale oil amounted to 6 million euros in the first quarter of this year, compared to just 1 million euro in the same period of 2016. Improvement in margins had a large positive impact, resulting both from better sales price as well as lower variable costs. Fixed costs had a net negative impact on EBITDA because while we were able to reduce maintenance costs, the fixed cost component of using up inventories had a negative effect. Additionally, as explained in the previous slide, gains from derivatives were lower this year compared to the first quarter of 2016. Last year, we had a small positive contribution from hedge positions whereas this year our new hedge positions had a lower price compared to current market price so they yielded a small negative effect on EBITDA. But, all in all, the quarter can definitely be considered an improvement for our shale oil business compared to last year.

On slide 17 we have summarised the rest of Eesti Energia's products and services. These include sales of heat and natural gas and certain industrial technological solutions. This is where we have also included the result from an important milestone that we achieved in the first quarter, namely the financial close of the Jordan power project. The project will now enter construction phase. Together with achieving the financial close, Eesti Energia has sold down its ownership in the project to 10% and will from now on take the role of a more passive investor. The first quarter's results include profit from the sell-down as well as the return of the development costs that we have made into the project over the years. The total effect in our first quarter EBITDA was 9.2 million euros. Part of the profit from the project had already been recorded in our earlier financial results. In addition to the Jordan project, we also recorded in our first quarter EBITDA 5 million euros of additional liquidated damages related to the Auvere power plant. This amount is on top of what was taken into account in our 2016 figures as it has been calculated based on the performance of the plant in 2017. In total, EBITDA from other products and services amounted to 15 million euros in the first quarter.

Now that we have summarised the performance of all business segments, let's turn to slide 18 to analyse the Group's operating cash flow. It can be said, that the first quarter of 2017 was an excellent quarter in terms of cash flow for Eesti Energia. The Group's operating cash flow amounted to 132 million euros, which is 45 million euros higher than EBITDA. Around 9 million of this is explained by CO2 related items, given that we do not have to purchase the CO2 allowances for the emissions immediately. Cash flow related to derivative instruments amounted to 20 million euros and this movement mainly comes from a reduction of the cash collateral that has been provided for our hedges and trading. Changes in various working capital items had a positive effect of 27 million euros. Majority of this, namely 25 million, was made up by a reduction in receivables from GE related to the agreed contractual penalty. The contractual penalty from GE was accounted for in Eesti Energia's EBITDA in 2016 but is payable to Eesti Energia under an agreed payment schedule this year. A negative effect appeared from the Jordan financial close transaction which yielded 9.2 million of EBITDA for Eesti Energia in the first quarter but the relevant cash flows from the sell-down and the return of the development costs show up in investment cash flows, rather than operating cash flow. As a result of these movements, the total result is 132 million euros for operating cash flow in the first quarter of 2017.

On slide 19 we have included an overview of how the operating cash flow in the first quarter of this year compares to the operating cash flow in the same period of 2016. As can be seen in the graph, Eesti Energia's operating cash flow more than tripled compared to the first quarter of last year. Part of the growth is explained by higher EBITDA in 2017. Cash movements related to collateral payments and other derivative related movements had a positive impact of 17 million euros. Similarly to what was explained in the previous slide, working capital changes had a much larger positive impact to cash flow this year. Majority of the effect is again related to the Auvere contractual penalty improving the cash balance as the payments are now being effected by GE. Effect from income tax is also positive in the two year comparison, given that Eesti Energia paid income tax in the first quarter of 2016 but not in 2017. In conclusion, it can be considered that the first quarter of 2017 produced a very strong result for the group on the cash flow side.

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Let's now move to slide 20 where you can see details about Eesti Energia's capex. Our capex has been declining over the past years and this trend continued in the previous quarter. Our total investments amounted to 26 million euros, down by 18% year-on-year. Majority of this amount or 14 million euros was made up of investments into improving the distribution network. Other maintenance investment remained stable at 2 million euros. As communicated with our annual report, GE continues their work on the Auvere power plant to upgrade the fabric filters so that the plant can be accepted by Eesti Energia towards the end of this year. While these works are ongoing, the plant will continue working at loads and regimes where the emissions are in compliance with requirements. The plant generated 461 GWh of electricity in the first quarter.

On slide 21 we have provided an overview of our cash balances and liquidity profile. Eesti Energia's cash position and liquidity buffer remain at a healthy level, which gives us comfort in the face of larger upcoming debt repayments in about a year. Due to strong operating cash flow in the first quarter of 2017, the balance of our liquid assets amounted to 343 million euros as at the end of March. In addition, we have revolving credit facilities set up with SEB and OP and an investment loan with EIB which we can still draw.

Moving on to slide 22, you can see that our leverage metrics have been improving over the past couple of quarters. Eesti Energia's net debt to EBITDA ratio stood at 1.7 as at the end of March. Such result is due to both healthy cash flow which reduces net debt but also due to relatively strong 12 month rolling EBITDA which of course also includes some one-off items such as Auvere contractual penalty from GE, recorded in the fourth quarter of last year. There have not been any changes in the debt repayment profile. Eesti Energia's ratings remain unchanged at BBB negative from S&P and Baa3 with stable outlook from Moody's.

Turning to slide 23, we can provide an outlook for the year 2017. We estimate that Eesti Energia's revenues will likely slightly grow in 2017 (defined as less than 5% growth), which is a change compared to the communication issued together with our annual report where we predicted that the sales revenues would grow, meaning higher than 5% growth. Investments are still expected to grow and EBITDA is expected to decline. If we adjust last year's EBITDA for extraordinary positive items including the liquidated damages and the retrospective reduction of the resource taxes, EBITDA for 2017 should remain at the same level as in 2016. Growth in investments compared to 2016 should result from final payments for the Auvere power plant and first payments for the new Tootsi wind farm. It is currently expected that Eesti Energia will pay 47 million euros of dividends in 2017.

Finally, to sum up the presentation today, the first quarter of 2017 can be considered a good one with Eesti Energia's business segments contributing to higher EBITDA. Closing the Jordan project yielded additional profits in the amount of 9 million euros to the Group. Investments declined in the first quarter but are likely to pick up in the second half of the year with some larger payments planned for development projects. Eesti Energia's financial ratios were at moderate levels as at the end of the quarter. We are now 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 * followed by 1 on their touch-tone telephone. If you wish to remove yourself from the question queue you may press * followed by 2. If you are using speaker equipment today, please lift the handset before making your selection. Anyone who has a question may press * followed by 1 at this time. One moment for the first question please.

Operator: There are no questions at this time. I hand back to Andri Avila for closing comments.

Andri Avila Thank you for listening and welcome back after three months for second quarter results. Thank you. Bye.