Eesti Energia Audited Financial Results 2012 Conference Call

MODERATORS:
MR. MARGUS KAASIK, CFO

Margus Kaasik: Hello. My name is Magus Kaasik. I am CFO of Eesti Energia and welcome you all to Eesti Energia's Annual Earnings Call. We will go now through the audited financial results for the last year.

I jump now straight to slide three, which recaps our result for last year. What we see is that we had a sort of stable year from the revenues point of view. Our revenues grew 1.3 percent. On the EBIT side we saw a slight decline of 2.7 percent and that is to note that is excluding the impairment cost that we had. On the operating cash flow side things improved compared to last year and our cash flow from operations was EUR185 million and that is up 14.5 percent. The CAPEX remained at this elevated level of above EUR500 million and basically was well on par with 2011's CAPEX. That was a short overview and now in more detail about our results last year.

Firstly – we are on slide four now – I would like to touch briefly on issues about Nord Pool, Estonia and our electricity price environment. What we see is that electricity price in our Nord Pool market in Estonia has declined over three years from 52, to last year it was 39. However, I think, what is good to note is that our, what is our dark spread - spread after CO2 cost and fuel cost is subtracted was actually a bit better than the year before despite the power price decline and this is due to quite a significant decline in the CO2 price that actually has benefitted us. Also what is interesting to note is that last year was one where prices in Estonia were higher than in Finland. During the first two years, Estonian prices lagged Finnish prices by about EUR6 per megawatt hour. Last year, actually, we were EUR3 per megawatt hour ahead of Finnish price and that is exactly what we have been telling before that the volatility of Estonian prices is much less than in the Nordic markets. There is, the power generators and the power supply had much stable prices and therefore when prices go significantly up in the Nordics they tend not to go so much up in Estonia and vice versa as well, when they plummet in Nordics, as they did last year, they do not plummet as much in Estonian market.

Now, the next slide – slide five – the revenue summary. As I noted the revenues were basically flat, 2011 and '12. Although there were quite significant changes between our different product lines the biggest gain was achieved in network services. Our revenues from the network services increased EUR35 million, quite a significant increase and also we did increase sales of oil revenues were EUR17 million up and then on the power side we had declining revenues especially in the unregulated market side. Altogether we had about EUR25 million reduction in power sales.

On the next slide there is more detail about power sales, firstly slide six is telling about the regulated market. Things were stable in the regulated market, as they tend to be usually. Sales volumes increased about 3 percent and that is in line with the electricity consumption growth in Estonia. The average price did decline about 1 percent. We did not change in price, as far as I know but the combination of different tariffs just gave us a little lower average price probably because those tariffs with the lower prices were used more during that year and altogether there was a 2 percent increase in the regulated power sales. The regulated market had ended as of end of last year, now we are on the new era of power market in Estonia and we can happily report that we were successful in this market opening exercise as we have made over 400,000 contracts with our clients in the open market side and that covers nearly 60 percent of all Estonian connection points. So it is, I think, quite a remarkable achievement but quite a small amount of clients remained on this public service that is offered on the back of Nord Pool power price and then our competitors also gained some market share but actually less than even we sort of anticipated.

On the next slide – slide seven – about the open market side. There we had sales declining. You see the 16 percent was a decline in sales volumes. However it is important to note that on the retail sides, and retail markets opened,retail markets in the Baltics we significantly increased our sales volumes from 2.0 terawatt hours to 2.7 or 2.8 terawatt hours and decline was mainly due to a decline in the sales to power exchange. The decline in the power exchange was mainly due to two things. Firstly, because we sold more on the retail market and we had less to sell in the power exchanges but the second note is that we also had first of all on the wholesale side rather low prices, at some point in time, at which we just did not want to generate and that did take away of that sales and secondly we also have a lower sulphur limit, sulphur emissions limit for our power generation in Narva and that did also somewhat decrease our output. Although, to be honest, we have been able to cope with that sulphur limit very well and even better than we anticipated at the beginning of that year.

But, coming back to this power sales on the open market; the volumes did decrease on the revenue side actually we were able to increase our revenues or prices – sorry – by 5 percent so altogether the net effect was 10 percent decline on revenues. Then it would be interesting or what we would like to highlight is that if you saw the Nordic power price or the Nord Pool power price in Estonia of EUR39 per megawatt hour then what we were actually able to achieve, sales price was 50 or 10 percent of 25, 10 Euros or 25 percent more and that is mainly due to, firstly we had good hedging in place. We hedged our exposure to some extent and that definitely helped us during those times where prices were pretty low on the power exchange and secondly also the revenues that we got from this Estlink power cable were quite significant, as the prices were quite volatile, the differences between Estonia and Finland were quite significant at times and we also, from that got quite a significant boost to our average sales price in the open market.

Next slide – slide eight – is about network services, sales and there you will see that the sale of our 3 percent increase which is basically the consumption increase in Estonia. You see quite a significant increase on the price side about 15 percent so altogether 18 percent more revenues. This price increase did not come directly all to our bottom line as part of it is due to price increases in the transmission network side, Elering, the transmission company, also has raised their tariffs, but some of it has still gone through to our bottom line as well and their profitability of the network services has improved significantly. The network losses were on a quite reasonable level, 6 percent. They were up a bit. They were even 5.8 percent a year before, but even the 6 percent is currently quite good result and this is well below the losses percent that is included in our tariff calculation and then is approved by the regulator.

On the next slide – slide nine – about the oil sales. We did produce oil as much as we have not done before so it is 211,000 tons mainly due to higher reliability over our old oil plants. They do now very well and so because of that we were able to sell more oil so the oil sales were close to 190,000 tons up 15 percent. We were also able to increase the sales prices by 11 percent so altogether 29 percent increase in revenues. Quite an achievement, to be honest we were expecting even a bit better result on the oil side, as we did expect that we also get some oil from our new oil plant which we did not, but on the inside what we can say that we probably were way too aggressive and too optimistic about how fast we can start-up the production in the new oil plant and hence so far we have not had any significant amounts of oil from the oil plant.

On the next slide – slide ten – about the other revenues, there we have seen a declining amount of other revenues and there are several reasons for that. One reason is that we have sold our telecom business and, of course, did not have any revenues from that effect is about EUR15 million altogether and second important aspect is about the CO2 allowances that we sold more CO2 and therefore we did get some revenues from that, although not profits.
I think I would like jump now to the next slide – slide 11 – and about the EBIT breakdown by our divisions. What we see here is firstly that the EBIT from our distribution network has increased significantly, 17 million is the increase in the network side. We do see that retail side, our retail division has increased their bottom line significantly that is actually mainly due to the different approaches that we have had in 2011 and 2012 and therefore the power purchase price has been different for them and they have been getting a better results out of power sales and, of course, we had one-off revenues or one-off profits also because of sales of this telecommunication business.

On the fuel side, we saw a decline that was basically, mainly, two reasons behind that, coming to that later as well, but mainly two reasons firstly the oil shale price, the internal oil shale price has remained the same although there is a significant cost pressure and the costs have increased so the profitability of the mining business itself has decreased and then secondly we had some one-off revenues or profits in 2011 regarding in respect to this Jordanian subsidiary sales, official sales of that and then you also see in this slide that the EBIT changes on a comparable basis were quite small from 168 to 163. But in addition to that we had impairment cost of EUR63 million and that left EBIT about EUR100 million.

Next slide, profitability by our segments first of all the retail side, here you see that we have had some revenue growth in the retail side, 6 percent, the OPEX has risen quite modestly by 0.4 percent and we have seen quite a dramatic increase in the EBIT of retail division and that is mainly due to two facts that I now mentioned already on the previous slide. Firstly, that the electricity margin has increased significantly and that has happened because basically now onto 2012 the retail business did buy all the electricity in with the power exchange spot prices and those spot prices were quite low during that year and most of the sales has concluded before that price decrease then that increased their margins significantly and also we did add net effect of EUR9 million of sales from this telecommunications subsidiary. We did have some significant cost increases as well that were due to higher cost that we incurred because of this market opening we had to increase the capacity of our retail channels significantly and that did bring in some cost also.

On slide 13, about distribution network have to report that we are able to achieve the profitability that the regulator has allowed us to get, so that is 7.8 percent and with distribution network we are very much content about the last year. Their performance has been excellent, they have been able to increase their bottom line significantly, able to achieve the regulated profitability and also in addition to that what is important to note is also all the quality metrics have improved significantly over the year as well, those customer disconnections and the biggest disconnection time has reduced quite significantly during last year. So we are very, very much happy with the results of the distribution business.

On the slide 14, on the generation front, we saw a quite a significant decrease in the margins it is also the generating division, generation division sells quite a lot to the spot market or basically all the sales that we sell on the open market through our retail channel is basically cleared between retail and generation division by the spot price so the weak spot price did hit the generation division and of course all the impairment cost is also in the retail division so if we look the results after impairment and we see that there is basically from the EUR19 million EBIT only five is remaining of the comparable basis, the comparison is much better basically comparing 70 to 80. So, does not look that bad anymore. The generation volumes did decrease about one terawatt hour and that was, basically two reasons for that. One is quite the low prices occasionally on the power exchange and secondly, the sulphur limit that was imposed to us.

I think I will now jump forward to page 15, about the fuels division. There we did see a decrease in the revenue side. We did see also decrease in the operation cost, but altogether that was quite a significant decrease from EUR71 million to EUR43 million. Quite a significant part of it is due to those non-recurring revenues that we had a year before, the EUR16 million is an effect from that played a significant part. Then EUR15 million was also due to the slower profitability of oil shale mining, as a result we kept the same internal price of the same regulated price as well for oil shale but the cost did increase over time. We had some environmental taxes and some other cost as well increasing during the year. We saw a decline also in the technology industry subsidiary where the work volumes did decrease somewhat as they did quite a big part of this construction works in this new oil plant and as this oil plant was basically mechanically complete already in mid last year then those revenues they were not able to replace fully and they saw less revenues and less profits on the second half of the year.

On the next slide – slide sixteen – we also have more details on the mining side and there we see that the decline that they had on the EBIT side was from 17 million to 2 million and lower sales volume was one reason behind that. Although they did mine a bit more, but they sold less as we did require less oil shale both for the new oil plant did not take oil shale and also we had less oil shale demand on the power side and so that had an effect and also the margins were weaker.

On slide 17 there are old effects, some, together looked at the Group level. What we see here, we see that basically three important items were what increased our bottom line. Most importantly, the higher profitability of network services did contribute significantly, EUR24 million to EBIT or positively on the EBIT growth. Secondly, we did have the year before some discounts and re-valuations on the CO2 and hedge instruments side that we did not have last year and that gave additional EUR15 million, I mean comparing those two years and also on the oil side, the oil sales, as we sold more and the prices were better the oil contributed additional EUR13 million to our EBIT. On the negative side, the most important negative effect came through our power sales or power generation/power sales and basically altogether if we look at the sales of oil and the also lower margin than EUR40 million were the net effect of less profitability in the power side. So, quite a significant decrease and then also we had a higher depreciation, as several new, several CAPEX that we did were finalised and things were put into operation and that did increase our depreciation.

On top of that there is this impairment of EUR63 million. About the impairment, most of this EUR63 million was done in Narva power plants – our main power generator – 58 from that 63. The main reasons for that impairment cost was that we have had a weakening outlook or prospects to our power business mainly because of the end of pre-CO2 era that ended for us this year. Now we have to buy the CO2 on the market. We had incurred a loss of bio electricity generation in Narva had quite a significant margin on that, we had before and we do not have anymore. Also we had some unexpected rises in the environmental taxes level, so all those different items put together gave us a bit weaker outlook for the profitability of our power business and Narva power plant in particular and for that we see that some impairment, that cost was in order.

On slide 18 about the cash flow. The cash flow itself was higher than a year before. First view to cash flows we will show how from the EBITDA of EUR278 million we will get to operating cash flow of EUR185 million and where the cash goes. Firstly, the one positive effect is that we have less some other current assets that give us some boost, from the negative side the interest and loan expenses took 26 million out of EBITDA there was CO2 related pre-payment and changes in provisions that were EUR23 million income tax EUR17 million. Sales of telecommunications subsidiary did effect the operating cash flow also by EUR14 million, basically a classification issue here and we had high inventories, as we mined more oil shale that we used because it is still better for us to mine sort of ahead as the mining related taxes are increasing year-by-year then it is actually good for us to mine as much as we can and then sell later. Inventories increased during the year-end that is EUR10 million but also receivables went up somewhat so altogether we see that EUR185 million is the cash flow that we got.

On the next slide we show that it was still better and 14 percent higher than a year before. The year before we had EUR162 million and this year EUR185 million. If we look at the different effects that we have here then more or less the biggest driver here is the CO2 and CO2 related changes in the provisions. So, the less pre-payments on the CO2 side altogether in net effect gave us the result.

On the CAPEX side – slide 20 – we still have a very high level of CAPEX that is EUR513 million even a bit more than we had a year before. Most of this CAPEX went to the new power plant that we are constructing in Auvere, its EUR208 million network investments were EUR100 million exactly; the oil plant 54 and others a bit less. What is definitely good and perhaps encouraging to note is our investment volumes are now declining. This year we do not expect to invest more than EUR438 million so quite a significant decrease comparing to this year and if we look years 2014 and 2015 then the committed investments in total are EUR563 million. So, less than EUR300 million per year on years 2014 and 2015, but these in respect of course the committed investments. We may over time commit more or may not, so that is something that we will see later in the future and then most likely this year we do not see that we would engage into any new significant commitments on the CAPEX side. So, the picture may look quite similar at the end of this year.

Slide 21, more details on the CAPEX side. Quite a significant part of the investments are completed or very near to completion. The two things will remain from here, we will even for the next three years build this new power plant in Auvere. Of course the distribution networks investments will continue, but most of the other investments are completed already or are completed in very near term, Enefit oil plant is mechanically complete, hot-commissioning still on-going, but we do not see any CAPEX going there. Desulphurisation equipment is by today already basically complete. There are some acceptance tests to do, but basically already done. Iru waste-to-energy unit also have had their first fire and we expect that they are already complete basically the plant is up and running in the next couple of months. Wind parks already completed and yes the international projects also there we will continue this pre-development period but the list will come much, much shorter over this year.

Slide 22, about the liquidity. The liquidity position for ourselves is excellent I would say it is excellent that we over time have been starting to reduce our liquidity lines that we have had. At one point of time the CAPEX amounts were so big that we did not really need quite significant lines of credit to demonstrate sufficient liquidity. Now the committed investment levels are declining. We do see that we need less liquidity line and that we have gradually started to reduce them. During the last year we also had two important reductions on the long-term financing side. We did issue a new Eurobond of EUR300 million that is maturing in June 2018 and we also got EUR115 million additional equity from the Government. So, on the long-term financing side we also feel quite comfortable currently. On the debt metrics thing that we perhaps follow the most is the net debt EBITDA and there we have demonstrated quite a significant increase but the level where we currently are 2.1 is definitely quite comfortable by our standards and it may increase somewhat but without any new investment commitments we do not see it drastically increasing.

We have reached the outlook picture – slide 23 – the outlook about revenues is that revenues should grow. The main reason, the two reasons behind that first is that we expect to sell more oil; oil that comes from the new oil plant and we also have higher prices for our power because the electricity market in Estonia is fully opened. So, there is a very good reason why the revenues should grow on the EBITDA side we also see that the EBITDA should grow and also one reason is that the oil amounts are higher and the oil profitability is reasonably high to set the EBITDA growing and, of course, there will be one major negative effect is about full CO2 expense which we will incur from this year on and that has negatively, but altogether we expect that our EBITDA will grow. I think the biggest driver or variable here is the new oil plant and, of course, those outlook estimations or this outlook task include some significant amount of oil from the new oil plant as well. If there would be no oil from the new oil plant then there would it would be quite a difficult task to grow our EBITDA.

Now, summarising the presentation; the revenues were stable. We did increase them by 1 percent and despite the revenues being stable, we were able to increase our EBITDA by 5 percent and that is mainly because of the higher sales margin on the network services side and higher profitability in the oil side. Capital base was significantly enhanced by EUR150 million of equity and EUR300 million of new Eurobonds so one with long-term financing we do feel comfortable right now. Investments were high, EUR513 million but we do see investment CAPEX declining, as projects are completed now, several of them. We had record high oil production from our old oil plant and from the New Year we do expect that our results will improve and we do get our things in order also in the new oil plant. So, thank you for listening. If you have any questions then definitely help to answer or clarify things that I did not make clear enough. Thank you.

Operator: Thank you. Ladies and gentlemen at this time we will begin the question and answer session for the financial analyst community. 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. The question will be answered in the order they are received. If you are using speaker equipment today, please lift the handset before making your selections. I repeat, if you would like to ask a question, please press the star followed by the one on the telephone. One moment for the first question. (Pause) Okay, right now there is no question. Mr Kaasik there are no further questions at this time. Please continue.

Margus Kaasik If there are not any questions, then definitely we are open to answer any questions investors and rating agents may have and are able to answer them by e-mail or phone as well, so please get in touch and we will definitely give you all the information you need, but thank you this time and soon in the end of April we are already reporting our first quarter results for 2013. Thank you and bye.