Eesti Engeria Second Quarter 2014 Results Conference Call

MODERATORS:
MR. MARGUS KAASIK, CFO

Margus Kaasik: Hello ladies and gentlemen, welcome to Eesti Energia second quarter earnings call. My name is Margus Kaasik and I am CFO of the company.

Now, let's jump straight to page three about the results of the quarter in a nutshell. We had revenues and EBITDA declining by about 6%, mainly due to a difficult operating environment that utilities currently tend to have. We also have a declining cash flow, operating cash flow, about 9%, but as our investments declined about 40%, then cash flow for that quarter was quite strong, and very well positive, so from the cash point of view, it was a very good quarter.

On the next slide, about the power market, here in Estonia, since we have now new interconnection in place between Estonia and Finland, then, as expected we have seen a, basically, almost full convergence of prices between Estonia and Finland. About 98% of the hours the prices were exactly the same, and this has had an impact, also, on spot prices. If we compare it to last year, then we saw spot prices going down about 22% in Estonia, and such decline did bring with it an even larger margin decrease. And the margin was down from €24 per megawatt hour to €12 per megawatt hour. So that is quite an important change from the market perspective.

On the next slide, about the next border, our interconnection between Estonia and Latvia, as the bottlenecks eased on the north side with Finland then they did actually get worse in the southern side of Estonia. So between Estonia and Latvia, the bottleneck was more severe than it was a year ago, so basically, what we saw was the spread between Latvia and Estonia go from 6 to €15 per megawatt hour. From this year, there are some limited hedging instruments in place, for us to hedge the Latvian power risk, but it is, as I said, quite limited, the amount of physical transmission rights that are auctioned yearly and monthly. The portfolio in Latvia and Lithuania, I would say the portfolio in Latvia and Lithuania is decreasing, about 1.5 terawatt hours is still left. We do have some additional sales in Latvia still going on, but it is all exchange linked, so we don't take any further cross border risks between Estonia and Latvia.

On the next slide about the oil market, the oil market has stabilised quite a bit, especially if you look at the quarterly figures. There has been no significant change in fuel oil prices, that is the reference product for our oil and the volatility is quite low, and both the Brent and crack spreads are quite stable. That has brought stability to fuel oil price.

On the next slide, a bit more about revenues and EBITDA, the picture is quite the same with both sales and EBITDA, as we have had a decline in the electricity side in both revenues and EBITDA and a significant growth in oil side, both revenue and EBITDA, and as the oil growth hasn't matched the decline in electricity then we do see decline in overall sales level and EBITDA level.

And now, two pages ahead, page nine, more details about electricity. If we look at what the actual sales price was, that we were able to get for our sales then actually the average sales price was higher, for us, than it was a year ago. Despite the fact that the spot prices were 22% down, and the main reason was hedges, we were hedged very well, and that covered, basically, all the generation volume that we had. On the volume side, we also saw on the whole 20% drop. Almost half of that drop is related to retail market and the rest to wholesale market. I must mention that while in the retail side we have actually seen market share decrease, and our sales on the retail side have decreased, then on the wholesale side, it's more about, more of a recognition issue. In a sense last year, during second quarter, we did net the cross border trade a bit differently than this year, so if we take that difference into account, then we see almost no change in the wholesale side, and in the generation side as well, we actually didn't see any change. And lastly perhaps to mention about power sales is that if we look forward for the second half of the current year, we are hedged pretty well. Again, about 5 terawatt-hours of sales is hedged and the average price is 43.7, which is pretty comfortable position to be in.

On the next slide, about the market shares, here you can see the change, or drop in the market share in Estonia. And as expected, our market share gradually declined after the market opening and now our market share is close to 60%. In Latvia and Lithuania, the changes have been less pronounced, and in Latvia, actually, the market share even has increased a bit due to additional sales that we have made. But overall, if we look the overall retail market share in the Baltic, it is now 26% instead of above 30% that was a year ago.

On the next slide, about profitability and the reasons behind the decline in the profitability of electricity. Then we obviously see that there has been quite a significant margin decline, if we look at the spot prices. That decline in the spot prices has been offset very well by the hedges and even more have we gained by the hedges than we have lost by the margin. But what is the additional margin impact is the border crossing costs as the bottleneck became more severe between Estonia and Latvia, then there was additional seven million cost that we incurred compared to last year. And secondly as the volumes were declining we also had impact from that to the profitability. So, all in all, if we take all those effects together then we do see that the main reasons behind the profitability drop is the increased cross border fees and increased provisions for Latvian and Lithuanian sales portfolios.

Now, coming to the next product that is distribution, slide 13. There the changes have been quite modest as expected of course, from the distribution side. The average tariff is a little lower than it was a quarter ago, mainly because the tariff fee decreased somewhat, because of the pass-through element of transmission, that was reduced, so we had to reduce our distribution tariff as well. And then secondly, also, we had some declined distribution volume that was mainly caused by the quite warm spring that we had. The temperature effect on the consumption in Estonia is quite significant. On the losses side we had quite a bit more network losses than we had last year, but I have to mention that this year 5% losses is more of a regular or normal figure than last year 3% was definitely lower than normal. And the main reason behind why we had such low losses last year, was because, from the beginning of last year, we had full market opening. We had the, sort of new arrangements for moving consumption data between the networks, between the sellers and there were some irregularities in the consumption data that were fixed later during the year. But they did cause quite abnormal low losses for that quarter.

On the next slide, on the profitability, again, the change is quite modest. The profitability in the distribution side has decreased about 2%. That is caused partly by reduction in the margin and then also by the lower volumes. It has been offset, to some extent, by a decrease in the fixed cost side, but not covered fully. Network operational figures are quite good. All the interruptions in the networks are less than they were a year ago, so from that end, we are doing pretty well.

The shale oil product on page 16, there the news are very good. We have been able to increase the average sales price quite significantly. Although the market price hasn't changed, but due to hedges mainly, we have been able to get a significantly higher price, 20% higher price on average than we did a year ago. The volume also has basically doubled since last year, and that has brought about 150% increase in revenues. So, the result is good indeed, and also, in the shale oil side, we are hedged quite well for the next half year. Most of the production volume that we can produce is hedged and the average market price is €471 per tonne. So we probably can expect that the hedges will add additional benefit to us also on the second half of this year.

Now about the profitability in the shale oil side, as expected, such a big jump in the volume side has increased EBITDA quite significantly. So about nine million is a positive effect from volume increase and additional two million also from financial hedges. So these were the most significant drivers. On the positive side, the margin itself was a bit lower, not much, but a bit lower, that is connected to increase in the production cost of shale oil.

Now, on the next slide, about other products. Nothing much to report here. Perhaps the only significant change is that we have got more revenue and more EBITDA out of sales of oil shale to third parties. We do sell very limited amounts of oil shale to third parties as well to other oil producers and there we have been able to increase our revenues and EBITDA by getting a somewhat higher price than what we did last year.

Next, on the cash flow, we did generate more cash flow than was EBITDA during the last quarter. The main reason behind it is the CO_2. As we do provision the CO_2 allowances cost into our P&L but we actually do cash out all those CO_2 allowances in December this year. Then, until December we have this, sort of, positive effect from CO_2 and in addition to that CO_2 effect, we did have some increase in the working capital as well, mainly by reduction in the payables side.

On the next slide, if we compare our cash flow from operations to last year's same quarter, then we do see some decrease, about 9%. The main reason behind it is the decrease in EBITDA, very close to five million was the decrease in EBITDA, and that's the main reason behind it. Changes in working capital have a less impact as change in inventories or change in payables more or less offset each other.

Now, on the CAPEX side, slide 21, as we indicated in the beginning we had about 40% drop in CAPEX, which has helped us to become seriously cash positive last quarter, and it is expected, as we have completed most of our investment program that we had. Still we are in the, sort of, final stages with this Auvere power plant, that was one of the major CAPEX items last quarter and second major item was distribution network. The other investments were sort of less important.

Now, the next slide about updates, about our new oil plant. We have had quite a good progress during last quarter, second quarter of 2014. The continuous operation time did increase, the availability of the plant did increase which was all good. Now the plant has been shut down to some maintenance work. We do improve some parts of the plant and get back to commissioning activities if all goes well during September this year and we do expect that those changes that we are now implementing during the summer have a good impact on the availability, improving further. And also, good news is that the oil quality and oil yield that we were able to get during the last quarter was very good, and this meets our expectations.

Next slide, about the liquidity. We have somewhat larger liquidity buffer than we had during last quarter, as we have had a good operating cash flow. If we look at the whole liquidity buffer, then we have about 200 million of liquid assets. We have €150 million revolving credit facilities available from SEB, Pohjola and Nordea, and also, we have ability to draw 100 million loan from the European Investment Bank. So all in all, about €460 million is available to us, and that is definitely sufficient to feel comfortable on the liquidity front and to finance our investment programs, dividend payments and other needs. So, things look very good.

On the next slide, about debt, our ratings are still the same that they were last quarter. We had BBB+ from S&P

and the Baa2 from Moody's. The most recent rating confirmation came from S&P on 16thJune this year, which confirmed our rating, but what they did, they did decrease our standalone rating to BBB-, so we have two notches uplift from the sovereign support. The leverage figures are fairly stable. For us, most important metric, is net debt to EBITDA that has increased during the year from 2.0 to 2.3, and the figures are, for us, comfortably lower from the, sort of, ceiling levels that we have imposed to ourselves and the ceiling is three times net debt to EBITDA.

Now, about outlook, page 25. Outlook is unchanged from last quarter. We still do see that the revenues could very well decrease slightly, mainly because of lower electricity sales volumes. We still expect EBITDA to be stable, roughly the same as it was last year, and we will see quite a significant drop in the investment levels. So, that's basically the same as it was a quarter ago. And also it is quite certain that we will pay a dividend to our shareholder, it has been decided the dividend amount is €114 million, and in addition to that, income tax to the state €30 million and as a pay-out of the dividend is scheduled for last quarter of this year.

Now, in conclusion, we did see a decrease in the sales revenues, 5%, to €200 million. That was caused mainly by decrease in electricity revenues, but we had quite a healthy result on the oil shale side. Also, we did see a decrease in EBITDA, again, mainly the culprit was electricity sales and especially the border crossing costs between Estonia and Latvia, and the good news from our investor perspective is strong cash flow position that last quarter, we were able to decrease our investments significantly, and we were firmly cash positive during the last quarter that was definitely helpful.

So, that was it, from my end, so if anybody has questions on our result, then we are happy to answer those. Thank you.

Operator: 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 touch tone 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 the 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.

Ladies and gentlemen, I remind you, if you would like to ask a question, please press star, followed by one on your telephone.

Excuse me Mr Kaasik, there are no questions at this time. Please continue with any other points you wish to raise.

Margus Kaasik: Good. If there are no questions, at this moment, then I thank everybody for listening, and see you and hear you during the next quarterly call, when we report the third quarter results. Thank you.