Eesti Energia Q2 2016 Results Conference Call

Speaker:
Andri Avila, CFO

Andri Avila:

Dear investors and partners. I am Andri Avila, the the Chief Financial Officer of Eesti Energia. I am glad to welcome you on our earnings call for the second quarter 2016 results. You can download the presentation that we will go through from our website.

So let's start off with the main part of the presentation. Slide 3 gives you a summary of the second quarter results. Our sales revenues declined by 18% and EBITDA by 21%. Oil and power prices remain at low levels and our hedge positions have been rolling off. However, compared to the first quarter the market situation has been improving and also the rate of decline in EBITDA has slowed down from -31% in the first quarter. On the positive side, our EBITDA was improved in the second quarter by a retroactive cut of environmental fees and resource taxes which contributed as one-off positive effect of 13 million euros to our EBITDA and will also support us going forward. We also did some changes in our production plans to take full advantage of this tax cut from the second half of this year. For example, our mining company had their holidays in June. This created 2 million additional cost in June but they will now be able to work at full speed for the rest of the year when the tax rates are lower. Looking at investments, you can see that Eesti Energia's capex declined by 63% to 32 million euros in the second quarter. Such drop is in line with expectations. Finally, there was also a decline in operating cash flow by 19% compared to the second quarter of 2015, which is in similar magnitude to the drop in EBITDA.

Before we turn to a more detailed overview of our financial results, let's first go through what has been happening at our key markets. In slide 4 you can see that while power prices in general remain at a low level, Nord Pool Estonia power price actually increased 4% year-on-year and averaged 31.4 EUR/MWh in the second quarter. Eesti Energia's Narva power plants continued selling at a higher price compared to the Nord Pool average, as we produce more during higher priced peak hours. The price difference was 7% in the second quarter. On the whole, power prices in the Nord Pool markets were influenced by maintenance works and outages of generating units and transmission cables. Price spreads between Finland, Estonia and the rest of the Baltic countries declined. Our clean dark spread improved owing to higher power price but also lower market price of CO_2.

Our financial results are also heavily influenced by global oil prices and this information we have provided on slide 5. The average price of 1% sulphur content fuel oil which is the benchmark product for our shale oil, declined by 40% in euro terms compared to the second quarter of 2015. However, we are glad to note that compared to the first quarter of this year, the price of fuel oil increased by 42%.

Next let's look at slide 6, where we show a summary of our quarterly financial results by segment. As I already mentioned, our sales revenue declined by 18% and totalled 149 million euros in the second quarter. EBITDA totalled 55 million euros, a decline of 21% year-on-year. The decline was mainly caused by the electricity and oil segments. The results of the distribution network were essentially flat year-on-year. EBITDA from the „Other" segment grew substantially and contributed 12 million euros to the group result. This is where we have accounted for the positive effect from the government's decision to cut environmental taxes. Now let's look at each of our business segments also separately.

Let's start with electricity on slide 8. Our sales volume totalled 1.7 TWh in the second quarter so same level as last year. This figure includes the sales of Auvere power plant. In our accounting, the sales revenue and costs of Auvere power plant are partially capitalised because the plant is still classified as under construction. Regarding prices, Nord Pool Estonia price increased year-on-year in the second quarter, but Eesti Energia's average electricity sales price declined by 12% and equalled 41 EUR/MWh. This was primarily due to rolling off of hedge positions. Declining price and sales volume in combination translated into a 22% drop in electricity sales revenue. When talking about hedges going forward, we have 2.1 TWh hedged for the remaining part of 2016 at 36.6 EUR/MWh and 1.8 TWh hedged for 2017 at 34.9 EUR/MWh. This includes both financial hedges and fixed price contracts with our retail clients.

Slide 9 gives an overview of our presence in the Baltic retail power market. Our combined market share in the Baltics totalled 25% in the second quarter, a 0.9 percentage point drop. In Estonia our market share is largest and amounted to 58%. Our market share in Estonia declined due to the impact from the large corporates segment and also due to decreasing network losses.

Now, let's look at slide 10 where we explain developments in EBITDA from our electricity product which amounted to 17 million euros, a decline of 47% from last year. The biggest driver behind this was smaller hedge positions, which explains 9 million of the total decline. Also the margin impact was negative, mainly due to higher CO_2 cost. While the market price of CO_2 has declined this year, our position of free allowances is smaller so our average cost of CO_2 in the income statement was higher. Our electricity sales volume after netting part of Auvere's revenues declined which also had a negative impact on EBITDA. On the positive side, lower fixed costs increased EBITDA by 3 million euros.

Moving on to distribution product in slide 12, you can see that both distribution volume as well as sales revenue were very stable compared to last year. On the positive side, network losses continued falling and amounted to 4% which is 1.2 percentage points lower compared to the second quarter of 2015.

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On slide 13 it can be seen that these lower network losses have also supported the EBITDA of the distribution segment. Distribution EBITDA grew by 2% in the second quarter and totalled 29 million euros. Unplanned SAIDI amounted to 54 minutes in the second quarter. The increase compared to the year before is attributed to some large summer storms that happened in the second quarter of this year.

On slide 15 we show the results of our third main product, which is shale oil. Our average oil sales price dropped to 198 euros per tonne, which was the result of lower global oil prices and lower gains from hedge positions.

Regarding hedge positions, we have 66 thousand tonnes of oil hedged for the remainder of this year at an average price of 367 euros per tonne. Looking at our sales volume in the second quarter, then this increased by 2%. Oil prices recovered from the lows seen in the first quarter and we resumed sales after storing some oil at the beginning of the year. Our oil production declined as there were more maintenance works in Enefit280 plant compared to the previous year. All in all, our revenue from oil sales declined by 43% and amounted to 14 million euros.

Moving to the next slide, it can be seen that our EBITDA from shale oil turned negative in the second quarter and amounted to -3 million euros. This was caused by lower oil sales price and lower gains from derivatives. Oil prices improved in the second quarter to a level where they covered our marginal costs and enabled us resume sales but where not yet high enough to also cover fixed costs.

Slide 17 concludes our review of the business segments with Other remaining products and services. The contribution to EBITDA from these items amounted to 12 million euros. The main factor here is the one-off impact from the retroactive cut of resource taxes and environmental fees which contributed 13 million euros to our EBITDA. The change in relevant legislation was approved just before the end of the second quarter. The new tax rates will have a positive impact on us also going forward as they make our production assets more competitive.

Now let’s turn to slide 18 and look at our cash flows. Our operating cash flow totalled 51 million euros in the second quarter, which is somewhat smaller compared to the EBITDA of 55 million euros. The difference is explained in the graph. We had a positive effect of 10 million euros from CO2 as we accounted for the cost of CO2 in EBITDA but we did not actually buy any CO2 allowances because we have a surplus from previous periods. We also had a positive effect of 5 million euros from the reduction in our oil and oil shale inventories. Other working capital items had a negative effect of 18 million euros. This is again mainly explained by the cut of resource and environmental taxes. As a result of the tax cut, our tax obligations for past periods were reduced by 13 million euros and this has been recorded as tax prepayment in our accounts. We can use this tax prepayment for covering our future tax obligations. So the tax cut had an immediate effect on our EBITDA but it will show up in our cash flow in future periods.

On slide 19 we have compared the operating cash flow in the second quarter of this year to the same period in 2015. Our operating cash flow declined by 12 million euros which is in similar magnitude when compared to the drop in EBITDA in the same period. Compared to the second quarter of last year, the effect from inventories was more positive this year as both our oil shale and oil inventories were reduced. Other working capital items had a relatively more negative effect. This includes the 13 million tax prepayment from the retroactive tax cut which we will be able to use up in future quarters and also some other items. But on balance, the development in operating cash flow has been in line with underlying development in EBITDA.

In slide 20 we give an overview of our investment projects. The trend of declining capital expenditure continued in the second quarter. Our total capex amounted to 32 million euros, down by 63% from the year before. Capex spending was mainly made up of investments into the electricity network. Regarding the largest development project which is the Auvere power plant, it has now become clear that electrostatic precipitators of the plant need to be upgraded before the plant is fully commissioned. Under the terms of the EPC contract, General Electric is responsible for making the required changes. There are also sanctions in place to cover our losses related to the delay. General Electric is currently preparing their final proposals for correcting the situation. Meanwhile the power plant continues operating at loads where the emissions can be kept in compliance with regulatory requirements. Turning to slide 21 you can get an overview of our liquidity profile, which was very solid as at the end of June. Our operating cash flow of 51 million euros was more than sufficient to cover the capex outflows so our total liquid assets amounted to 190 million euros as at the end of the second quarter. Eesti Energia’s total liquidity buffer was additionally boosted by 150 million euros of revolving credit facilities and 70 million euros undrawn loan agreement with European Investment Bank.

On the next slide you can see that our debt repayment schedule remains favourable with only minor repayments in 2016 and in 2017. In terms of debt metrics, Eesti Energia’s net debt to EBITDA metric increased to 3.4, driven by lower EBITDA. There were also some rating actions in the second quarter. Eesti Energia’s rating was downgraded by Moody’s in April. Their rating is now Baa3 with stable outlook. Standard & Poor’s confirmed their BBB rating in June. The rating has a negative outlook.

As one of the final items, let’s look at slide 23 where we provide some guidance for 2016. Our outlook remains unchanged from the end of the previous quarter. We forecast that Eesti Energia’s 2016 revenues will decline less than 5% from last year’s level. For EBITDA we estimate a more than 5% decline from the previous year’s result of 266 million euros. As we have seen some improvement in market prices from the beginning of the year and given that we have new lower tax rates in place, we are relatively optimistic regarding our production volumes of oil and electricity for the second half of this year. Regarding capex outlook, we expect investments to decline by more than 5% from last year's level. As for dividends, we expect that Eesti Energia will not pay any dividends this year in accordance with the shareholder resolution.

To sum up our presentation, both Eesti Energia's revenue and EBITDA declined in the second quarter, mainly due to the electricity and oil segment. Then again, we also had a positive effect from reduced environmental fees and this is a positive development also going forward. In line with lower business volumes and completion of investment projects our investments also decreased substantially.

We have now completed our presentation. In case you have any questions, we would be glad to answer these.

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. 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: Ladies and gentlemen, if you would like to ask a question, please press * followed by 1 on your telephone. Excuse me sir, there are no further questions at this time. Please continue with any other points you wish to raise.

Andri Avila That's it from our side. If you have no further questions then talk to you again in three months. Thank you.