Eesti Energia Q3 2016 Results Conference Call

Speaker: Andri Avila, CFO
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Andri Avila: Dear investors, dear partners. I am Andri Avila, the Chief Financial Officer of Eesti Energia. Thank you for joining our regular update call. I hope you have managed to download the presentation with our third quarter financial results from Eesti Energia website.

We start the presentation with slide 3, where we have provided a high level overview of our third quarter results. Eesti Energia's sales revenues were almost flat year-on-year as higher sales volumes of oil and electricity countered the effect of lower sales prices. EBITDA declined by 22% to 52 million euros but operating cash flow was very strong at 55 million euros, more than doubling from last year. Investments declined by 30% and amounted to 33 million euros.

As usual, before turning to a more detailed overview of the financial results, let's have a look at what has been happening in the markets. On slide 4 you can see that Estonian power price reached 31.6 EUR/MWh in the third quarter, up by 4% from the same period in 2015. Nordic hydro reservoirs remained below their historical median during the quarter which was supportive for the region's power price. The third quarter was also characterised by low price spreads between the different price areas in the Nordics. The prices in Estonia and Finland were essentially equal. Also the price spread between Estonia and Latvia decreased substantially owing to the NordBalt cable between Lithuania and Sweden. Eesti Energia's clean dark spread improved quite substantially in the quarter both due to higher power price and also lower market price of CO2 and lower cost of oil shale. The cost of oil shale declined as a result of the changes in environmental tax rates that took effect from July this year.

On slide 5 we have provided an overview of liquid fuels prices. You can see that the prices continue to be lower year-on-year but have increased since the slump at the beginning of 2016. The price of 1% sulphur content fuel oil, which is our reference product, averaged 215 euros per tonne in the 3rd quarter. This is a 1% decline compared to the 3rd quarter of 2015 but a 19% increase compared to the second quarter of 2016. Fuel oil performed better in the third quarter compared to Brent. The price difference between the two products is illustrated by the crack spread which declined during the last quarter to 8 EUR per barrel.

Now moving on to slide 6, we start looking at the financial results in greater detail. As mentioned earlier, our sales revenues were basically flat last quarter compared to the same period a year before. When looking at the result of the various business segments, it can however be seen that our revenues from electricity sales increased while shale oil sales declined. What we can also say is that sales quantity grew for both electricity and oil but the decline in average sales price outweighed the volume impact for oil. EBITDA declined by 22% in the third quarter and amounted to 52 million euros. This was driven by almost equal magnitude by both electricity as well as oil segment. However, compared to the 55 million euro EBITDA that we achieved in the second quarter of this year, our results were roughly on similar level also in the third quarter.

On slide 8 let's take a closer look at the results of the electricity segment. As can be seen, our electricity sales volume increased substantially, by 35% in the third quarter. This was mainly driven by larger wholesale volumes as the competitiveness of our generation assets was improved by higher Nord Pool electricity price and lower production costs. Lower costs were both due to the decline in the market price of CO2 allowances and also decline in the cost of oil shale production due to the recent tax changes. While our production and sales volumes increased, our average electricity sales price declined by 11.5 EUR per MWh to 37.6 EUR. This was partly driven by lower gains from derivatives but also by the decline in the price of retail sales as the lower level of market prices gradually feed into retail term contracts when these get renewed. Also since our generation cost was lower, we produced relatively larger quantities of electricity also during lower priced off-peak hours which still created variable profit for Eesti Energia but contributed to lower average sales price. In combination, our revenue from electricity sales increased by 7% during the quarter as the growth of sales volume outweighed the decline in sales price. We would also like to point out that in the 3rd quarter as prices rose, we resumed our hedging programme and have increased our hedge positions for both the fourth quarter of 2016 as well as for 2017.

On slide 9 we look at our retail market shares. Eesti Energia's combined market share in the Baltics totalled 24%, which is 0.8 percentage points lower compared to last year. The drop is mainly related to Estonia and the reasons behind this are the same as outlined during our previous quarterly calls. Namely, at the beginning of 2016 we lost a client in our large corporates segment and mainly this has contributed to our lower market share since the start of this year.

On slide 10 we split up the EBITDA development of the electricity product. Despite growing sales revenues, EBITDA of the electricity segment declined by 23% last quarter. Growing volumes had a positive impact of 17 million euros on EBITDA, but the margin impact was negative by 13 million euros. Our sales were made at lower average price and although there was also a decline in variable costs, the net impact was that our margins declined compared to the year before. So we produced and sold larger quantities of electricity which earned us smaller but still positive margins which help us to cover our fixed costs. We also had lower gains from hedge positions, compared to the third quarter of 2015. In total EBITDA from the electricity segment came in at 24.5 million euros.

Let's now look at the performance of the distribution network. On slide 12 it can be seen that both the average sales price as well as sales quantity increased for the distribution segment, which translated into a 2% increase in sales revenue. Network losses have been gradually declining and equalled 4.2% in the third quarter, almost flat year-on-year.

Moving on to slide 13, our EBITDA from the distribution segment declined by 3% in the third quarter. This was mainly driven by higher costs of unplanned maintenance works that were needed due to storms. The effect of these unfavourable weather conditions is also reflected in unplanned SAIDI, an indicator of the duration of service interruptions which totalled 54 minutes in the third quarter, a higher level compared to last year.

Let's now turn to slide 15 where we have provided information about our third main product, shale oil. Our shale oil sales volume increased by 21% in the third quarter, supported both by higher production as well as using up inventories. The average sales price meanwhile declined by 38% and equalled 211 euros per tonne. The drop resulted solely from lower gains on derivatives as our old hedge positions, which we entered into at much higher price levels have gradually rolled off. Our average sales price excluding the gain on hedge positions actually increased by 5%, despite a decrease in the price of the reference product. We would also like to draw your attention to the fact that as the market price of fuel oil has improved, we have again started to build up our hedge positions. For example, we have 191 thousand tonnes of oil hedged for 2017, at an average price of 228 euros per tonne.

On slide 16 we have included information about the EBITDA of the oil segment, which totalled 1.6 million euros in the third quarter, a decline of 7.7 million euros compared to the year before. The decline has primarily resulted from lower gains on derivatives which had a negative impact of 11 million euros. Higher sales volumes in turn had a positive impact on EBITDA as did an improvement in margins.

On the following slide 17 there is an overview of the rest of our products such as heat and gas, and also some services. These make up a relatively small share of Eesti Energia's total results and had a total negative contribution to EBITDA in the amount of 2 million euros in the third quarter.

Now let's have a look at how the EBITDA that we earned was turned into operating cash flow. On the lefthand side of the graph we start out with EBITDA of 52 million euros. Compared to EBITDA there was a net positive effect to cash flow from CO2 related items. Namely, the cost of CO2 enters our income statement regularly as we produce electricity and oil and emit CO2 but we purchase CO2 allowances in more concentrated portions usually at the end of a year. This positive effect was somewhat mitigated by collateral payments in relation to our CO2 hedge positions but overall we still had a positive effect in the amount of 7 million euros from CO2. Moving on to next items, we had a decline of both oil shale and oil inventories last quarter, which had a positive impact of 8 million EUR to our cash flow. Also a number of other working capital items combined had a 12 million euro positive effect. On the negative side, we paid interest on our bonds and loans in the third quarter, which reduced our cash flow. So all in all, we generated 55 million euros in operating cash flow in the third quarter, up by 5% year-on-year, despite a decline in EBITDA.

On slide 19 we give you an overview of how operating cash flow has changed compared to the same period last year. In the third quarter of 2015, Eesti Energia's operating cash flow amounted to 26 million euros. It can be seen that although we had a 15 million euro drop in EBITDA, our operating cash flow was higher this year. This was mainly a result of much more positive developments relating to various working capital items. Whereas our inventories grew last year, we had a reduction of inventories this year, giving a combined positive effect of 17 million euros. Also other working capital items contributed +15 million euros. Additionally, our interest payments were lower in the third quarter of this year as a result of the refinance transaction that we did last year. The transaction affected the timing of the interest payments between quarters but also reduced the level of interest payments going forward. In conclusion, despite a fall in EBITDA we had a strong quarter for operating cash flow, which more than doubled compared to last year.

Next let's turn to an overview of our investments on slide 20. Our capex amounted to 33 million euros in the third quarter, down by 30% from last year. In line with what we have seen in previous quarters recently, the majority of the investments went into upgrading the distribution network. A smaller share was made up of other maintenance type of capex. In relation to Auvere power plant, discussions are ongoing with the contractor General Electric about the timeline going forward, as there is a need to do some additional works on the filters before the power plant can be fully accepted by Eesti Energia.

Moving on with a discussion of our liquidity and financial position, on slide 21 you can see that our liquidity buffer remains at a very healthy level. We had 205 million of cash and cash equivalents as at the end of the quarter. In addition, we had 220 million euros of undisbursed loans available. In September we extended the availability period of the 70 million euro European Investment Bank loan by another year until October 2017 as we do not see an immediate need for taking out this loan.

On slide 22 you can see key information about our financial metrics and funding profile. Whereas Eesti Energia's financial leverage was unchanged at the end of the quarter, our net debt to EBITDA ratio slightly increased and is now at 3.5 times. Our financial policy remains at maximum 3.5 times net debt to EBITDA and we expect that the ratio would be somewhat improved by the end of this year.

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Turning to slide 23, we provide an outlook for the financial year of 2016, where we still have just one quarter to go. Our guidance is unchanged from our last report. We expect that our full year sales revenues will decline less than 5% compared to 2015, whereas EBITDA will decline by more than 5% compared to last year's result of 266 million. Investments are also expected to decline. In terms of production volumes, we expect that our electricity generation quantity will grow as it is supported by lower environmental fees and now also by a recent improvement in market prices.

So to sum up our presentation today, we saw a quarter of stable revenues, as our sales volumes grew both for electricity and oil. Our EBITDA still declined from last year but overall we can say that market conditions have somewhat improved and this has also allowed us to resume our hedging programme, which is important for decreasing the volatility of our financial results. We also saw another quarter of declining capex, as there were essentially no payments made in relation to large development projects.

And perhaps it is also worth mentioning that there is a slight change in our financial calendar. The publishing of our annual report is now shifted from 28th of February to 27th of February. And that's it currently from my side, so we are now ready to take any questions 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: Excuse me Mr Avila, there are no questions at this time. I hand back to you for closing statements.

Andri Avila Thank you for listening our third quarter results and if there are no questions then speak to you again after three months. Thank you.