Eesti Energia Unaudited Financial Results for Q3 2017

30 October 2017

Transcription

<u>Speaker key</u>

AA	Andri Avila
OP	Operator

Andri Avila Dear partners, welcome to our regular investor call. My name is Andri Avila, I am the CFO of Eesti Energia. We will be discussing Eesti Energia's third quarter financial results at this call and you can also find the relevant presentation at Eesti Energia website.

On slide 3 let's first have a quick overview of the third quarter. You can see that in contrast to rapid year-on-year improvement in revenues and EBITDA which was seen in the first half of 2017, third quarter results were somewhat more modest. Sales revenues declined by 8% to 158 million euros while EBITDA grew by 3% to 54 million euros. Operating cash flow dropped by 29% primarily due to working capital impact and an advance purchase of CO2 allowances, a similar transaction as in the second quarter. Investments were at a relatively stable level of 35 million euros.

Next let's move to slide 4 where we have provided an overview of the power markets in the third quarter. The average electricity price in Nord Pool Estonia totalled 36.1 euros per MWh, which is a 14% increase from the same period last year. The price difference between Estonia and Finland remained at a very low level of 0.1 euros per MWh. Despite maintenance of the Nord Balt power cable between Lithuania and Sweden, the price difference decreased also between Estonia and Latvia. The Latvian electricity price was 1.1 euros higher than Estonian price. Eesti Energia's clean dark spread against NP Estonia increased to 10.3 euros per MWh.

On slide 5 we have also given a snapshot of the movements of global oil prices. The average price of Brent crude oil increased by 15% to 53 USD per barrel in the third quarter in year-on-year comparison. The average price of our reference product 1% sulphur content fuel oil increased slightly more, by 19% in euro terms, to 256 euros per tonne. In quarterly comparison, Brent price increased while fuel oil price declined by 2% due to low local demand on the European fuel markets and decreased exports to Asia.

Starting with slide 6, we will be going through the financial results in more detail. Eesti Energia's sales revenues totalled 158 million euros, down by 8% from last year. EBITDA increased by 3% to 54 million euros. Market prices and margins improved but the results of the electricity and oil segments were also affected by lower production and sales quantities. Lower quantities were to a large extent driven by scheduling of maintenance works. In 2016 we witnessed very low market prices in the first half of the year and more maintenance works were planned into the first two quarters. However, there was no such effect this year and relatively more maintenance works in the power plants were carried out based on regular maintenance schedule in the summer. When looking at the distribution segment, the reason for the decline in revenues and EBITDA was the change in the distribution tariff since July. Third quarter results also include additional contractual penalty payments related to Auvere power plant and these are recorded in the Other segment.

On slide 8, let's go through the results of the electricity segment in greater detail. As mentioned before, power prices increased in the third quarter and Eesti Energia's sales price also grew by 5% to 39.5 euros/MWh. At the same time, the Group's electricity sales volume declined by 14% to 2.1 TWh, primarily due to lower wholesale quantity. Electricity generation amounted to 2.1 TWh, also down by 16% year-on-year. As already briefly explained before, we have returned to a more regular schedule of power plant maintenance and carried out relatively more repairs in the summer compared to the third quarter of 2016. In 2016, maintenance works were done earlier in the year, that is in the first and second quarter, due to low electricity prices in this period and also due to the expectation of lower resource fees that took effect from July 2016. Last year it was a target to have the power plants in full production capability by the third quarter when it was expected that margins would improve. However, there was no such effect this year. The combined effect from higher sales price and lower sales volume is 80 million euros of sales revenue, which is an 8% declined compared to the third quarter of 2016.

On slide 9 we continue the analysis of the electricity segment in terms of EBITDA. It can be seen that higher average sales price and resulting higher margins had a positive impact on EBITDA which tempered the negative impact from lower volumes. Fixed costs were slightly higher compared to last year. The expectations for production volumes of Narva power plants have been increased and accordingly also more maintenance works have been done in the plants. In total, EBITDA from electricity segment amounted to 18 million euros in the third quarter.

Next, let's move to the results of the distribution segment on slide 11. It can be seen that unlike the usual there were some relatively large movements in the financial results of the distribution segment this quarter. The reason is the change in the distribution tariff that took effect from the beginning of July. Accordingly, average distribution sales price declined by 8%. It is expected that there could be some additional decline in the average distribution sales price going forward, as clients will be adjusting to new tariffs and switching between different pricing options. Higher volume of distributed electricity reversed some of the decline so sales revenues from the distribution segment declined by only 4% and totalled 53 million euros. Once again we are happy to report that network losses were at a low level of 4.2% in the third quarter.

Looking at the next slide, distribution EBITDA declined by 3% and amounted to 27 million euros in the last quarter. The result is driven by the change in tariffs and resulting lower average sales price, whereas higher volume and lower fixed costs had a positive impact on EBITDA development.

On slide 14 information about the shale oil segment is presented. While market price of shale oil increased on annual basis by 19%, Eesti Energia’s average shale oil sales prices declined by 1% as hedge positions had been entered into at somewhat lower levels than current market price. Shale oil production declined by 17% due to higher volume of maintenance works in the third quarter compared to the year before. Similarly to the electricity segment, part of the difference in maintenance schedules was due to low market prices of oil in the first half of the previous year which was used for getting maintenance done. However this year, the planned maintenance of the Enefit 280 plant took place in August instead. The sales volume of oil also declined as production was lower and there was an additional effect from postponing two large shipments from September to October. In total, revenues from shale oil declined by 22% and amounted to 15 million euros. You can also see information about hedged quantities and hedge price levels on this slide.

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While revenues from shale oil declined in the third quarter, shale oil EBITDA increased by 31%, mainly due to positive margin development from higher market prices. Declining sales volume and negative result from hedge positions had an opposite effect and reversed some of the positive margin development but all in all, shale oil EBITDA amounted to 2.9 million euros in the quarter which is an improvement from last year.

On the following slide 16 the financial result of other products and services has been summarised. The largest item here is clearly the liquidated damages related to the Auvere power plant which had a positive impact on EBITDA in the amount of 9 million euros. Other movements included an improved result from heat sales and higher natural gas sales revenues. In total such other products and services yielded an EBITDA of 6 million euros in the third quarter.

Now let’s turn to the analysis of Eesti Energia cash flow. On slide 17 you can see that operating cash flow was lower than EBITDA in the third quarter. The main drivers behind this development were the following. Regular interest payments on loans and bonds were made which accounts for 20 million. Working capital also had a negative impact of 6 million, mainly due to growth in client receivables in the energy retail business, which was caused by seasonal effects, higher sales volumes for some products and starting sales of gas in Latvia. Derivative instruments and co2 related items had a combined positive impact. In total, operating cash flow amounted to 39 million euros.

Moving further to slide 18, it can be seen that there was a decline in operating cash flow compared to the equivalent period of 2016. The largest factor was from changes in working capital which had a negative impact of 26 million compared to the year before. There was no single item in the working capital that created this result, rather it was a combination of an increase of client receivables and inventories of oil shale and oil and a number of movements on the current liabilities side. Derivative instruments had a positive impact compared to a year ago while CO2 related items had a negative effect. Similarly to the second quarter of this year, we purchased in advance some CO2 allowances to cover our yearly emissions and simultaneously earn a small yield from investing our cash. There was no such purchase of CO2 allowances in 2016 which creates the negative impact in annual comparison.

On the following slide the development of the group's liquidity position has been shown. It can be seen that Eesti Energia's liquid assets remained at a healthy level of 308 million euros as at the end of September. Total cash flow was minus 78 million euros in the quarter as investments and debt service outweighed cash earned from operations. It should be noted however that investment cash flow also includes a short term financial investment of 35 million euros into a trade relating to CO2 allowances which enables us earn a small return on our cash. The trade involves purchasing co2 allowances and selling them at a fixed price in the future. Another comment on the liquidity position is that the deadline for disbursement of the 70 million euro loan from EIB has now expired and it was decided not to draw the loan due to sufficient liquidity.

And seems I missed slide 19 which we will now go over, which is a snapshot of our CAPEX expenditure.

Eesti Energia's total investments amounted to 35 million euros and distribution network continued as the largest item at about 18 million euros. Other maintenance type of investment totalled 8 million euros. On developments, about 2 million euros was invested in the project to increase the capability of one of our power blocks to use retort gas as fuel. The objective of the project is to increase the flexibility of running the power units as prices change on power markets. The total size of the investment is 15 million euros out of which now more than half has been invested.

In Auvere, works continue on the final completion of the power plant. The required filters have been installed but final testing of the power plant still continues and hopefully should be completed within the next few months.

Looking at slide 19, it can be seen that Eesti Energia's capital expenditure was stable compared to a year ago and amounted to 31 million euros. Investments into the distribution network continued as the largest share of the capex, making up about 17 million euros of the total. Other maintenance type of investment increased to 5 million euros as large electricity generation volumes also require somewhat higher level of maintenance and repairs. Regarding Auvere power plant, General Electric continues their work on the filters which needs to be completed before final acceptance of the project and which is scheduled for the autumn of 2017. Meanwhile, the plant continues working at levels possible in order to comply with emissions requirements.

On slide 21 information about funding and debt of Eesti Energia is provided. Eesti Energia's credit ratings by Moody's and S&P remain unchanged from the second quarter. In July Eesti Energia repaid EIB loans in the amount of 48 million euros to manage its liquidity position. The loans would have been normally due by 2019. The group's leverage metrics remain at a reasonable level. Net debt stood at 1.6 times EBITDA but it is expected that the ratio will increase by the end of this year as the EBITDA in the fourth quarter of last year was impacted by some extraordinary positive items.

Let's now move on to slide 22, which includes the outlook for the full year of 2017. The outlook remains the same as provided in July with second quarter results. It is still expected that Eesti Energia's sales revenues will grow by less than 5%, whereas EBITDA is forecast to decline by more than 5%. If we make an adjustment for certain one-off positive items which were included in EBITDA in 2016, the result for 2017 is expected to remain at similar level. Investments are expected to grow in 2017 mainly due to development projects.

Finally, to sum up our today's presentation, in the third quarter there was no longer similar quick improvement in financial results on annual comparison as had been seen in the first half of the year. This was partly due to scheduling impact of maintenance works, which resulted in lower production and sales volumes. However, market prices improved for both electricity and oil and this gives us a good starting point for the fourth quarter. We are not ready to take your questions.

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 selections. Anyone who has a question may press * followed by 1 at this time. One moment for the first question please. The first question comes from the line of Andreas XXX with Nordea. Please go ahead.

Guest Good afternoon, gentlemen. Few questions, if I may, on the the CAPEX side. It would be interesting to hear what you expect going forward 2018-2019. What should you expect CAPEX level? How CAPEX level will develop from current levels? The second question I have is linked to discussions that I understand is taking place regarding IPO's of the renewal business or partial IPO of the renewal business. That would be interesting to hear if anything else happened on that side. Thanks.

Andri Avila Thank you for the question. First question was about 2018 CAPEX, how we see CAPEX moving forward. As you know, we are not giving out specific guidance for coming years. But what I can say is that if the projects which we see right now in pipeline will realise in the expected schedule, then we see somewhat increase in CAPEX for 2018 and possibly also for 2019, which is actually in accordance with our strategy which can also be found on our website. But as I said, it will be a slight increase, it will not be several times increase compared to what we see this year, for example. But definitely there will be higher investment amounts in certain periods in coming couple of years. I hope it was enough, because I cannot really be more specific at this time. Regarding IPO, yes, it is still in our plans. It depends on available investment projects specifically in our renewables business, but what I just want to say is that IPO for us is not a target in itself, but just a way for financing our strategic investments. And the schedule and timeline and the size of course heavily depends on our pipeline and realisation of projects. So this comes first and the next step is the actual IPO pipeline, IPO schedule and this is kind of logical order. So we will not go and do IPO regardless of anything else. And saying that, it also means that the exact schedule will depend on our progress in developing those pipeline projects.

Guest — OK. Thank you very much. And just to be clear, when we speak about IPO, it's purely the renewable part of the business, nothing else?

Andri Avila — Yes, yes. Up to 49% of our renewables subsidiary.

Guest — Thank you very much.

Operator — Ladies and gentlemen, if you would like to ask a question, please press * followed by 1 on your telephone. There are no further questions at this time. I hand back to Andri Avila for closing comments.

Andri Avila — Thank you for listening. Our annual results will be announced on 27th of February. The schedule has changed, before it was 28th. We brought it one day closer. Hope to have you all participating in that call on 27th of February. Thank you.