Eesti Energia Audited Financial Results for 2019

28 February 2020
Transcription

Andri Avila

Dear investors and partners, my name is Andri Avila, the CFO of Eesti Energia. I am glad to welcome you on our regular conference call introducing Eesti Energia's 2019 financial results. We will be discussing the group's audited 2019 full year financials. I hope you have had a chance to download the report and the investor presentation from our web site.

Starting on slide number 3, Eesti Energia's sales revenues increased by 9% in 2019 reaching above 956 million euros, while total revenues crossed for the first time ever the 1 billion euro mark totaling at 1.02 billion euros. Group EBITDA in the same time decreased by 8% to 259.8 million euros. Revenue growth was driven by a higher sales price of electricity and better sales of shale oil. In terms of the core products, the Group's EBITDA saw increasing support from electricity and shale oil. For both products, growth was mainly underpinned by higher sales price and, in the case of shale oil, also by larger sales volume. Electricity distribution EBITDA decreased due to a decline in the tariffs in the beginning of 2019. Operating cash flow amounted to 147 million euros, down by 19 million euros from 2018 figures. The Group's capital expenditure in 2019 amounted to 136 million euros which is 30% lower than in 2018. We will be reviewing the financials in more detail in the upcoming slides, but before that let's cover the developments of our main commodity markets.

On slide 4 we will provide a brief overview of the electricity market. In 2019 electricity prices were on somewhat lower levels than in 2018 as we saw the recovering of the Nordic hydro levels, less maintenance works of interconnectors and Nordic nuclear power plants. Average electricity price in NordPool Estonia price region for the whole 2019 was 45.9 euros per MWh, a 2.6% decrease compared to 2018. The price differences in the region, between Estonia-Finland and Estonia-Latvia, narrowed during the course of the year. Due to high CO2 prices throughout the year, 2019 can be marked down as a first year after a long time when Estonia imported more electricity than it exported. Latvia and Lithuania have been electricity importing countries for a while by now, with Estonia joining the company. Nordic and Baltic electricity markets continue to be dominated by hydro and nuclear power production units. In 2019 we also saw increasing inflows of Russian electricity imports coming to the NordPool region through Finland and Lithuania.

Now that we already mentioned the high CO2 prices, let's turn our attention to the Clean Dark Spread. This metric shows the margin available to electricity producing oil-shale based Narva Power Plants after oil shale and CO2 costs. The metric declined heavily during the year mainly due to rising CO2 prices and ended 2019 at a level of -0.6 euros per MWh. The average figure for the full year was 2.0 euros per MWh. Question might arise, how can electricity production from oil shale be profitable in such circumstances. The answer here comes in two parts. First, in the Clean Dark Spread metric we use the market price of CO2 quotas, whereas in the Income Statement the average reserve price of the CO2 quotas is used. The average reserve price of CO2 quotas is lower than the market price due to free allowances received in the past and thanks to surplus quotas bought at lower price levels as a result of hedging policies.

Secondly, Narva Power Plants aim at producing electricity during hours where the electricity prices are higher, the so-called peak-hours. This is confirmed by the fact that Narva power plants achieved on average 7% higher electricity sales price compared to the average electricity price in the NordPool Estonia area. The same figure in 2018 was 2%. The increased differential is the result of the efforts of our engineers who continue to raise the level of operating flexibility at Narva Power Plants. Those power plants were projected and constructed decades ago to work at stable baseloads, but our engineers have managed to redesign the plants to be used as flexible power production units. This is a new dimension to the electricity production that we have introduced in the recent years and an area we will continue to develop.

Although the 2019 oil markets can be described as turbulent taking into account all the events that took place during the year, we can still say that from our standpoint the markets were supportive. The average price of Brent crude oil in 2019 came down by 10.6% to 64.1 dollars per barrel, while the price of 1% Sulphur content fuel oil rose by 2.7%. The divergence in prices is explained by the fact that although there were, and still are, macro-economic head winds, the fuel oil prices are being supported by the tougher regulations on the Sulphur content of marine fuels. The Sulphur content of our oil products is well in line with the International Maritime Organization latest regulations, therefore we see good demand for our oil products going forward.
On slide 6 let's start the review of Eesti Energia's financial results in more detail. Strong results of the electricity and shale oil segment translated into 9.3% growth in Group sales revenues. At the same time EBITDA declined by 8.2% led by the distribution business as the regulated distribution tariffs were cut in the beginning of last year. EBITDA from other activities declined on a yearly comparable basis mainly due to the Auvere power plant's liquidated damages that we received in 2018, but not anymore in 2019.

On slide 8, let's look at the results of the electricity segment in more detail. Although the average electricity prices in the region fell on a yearly comparison basis, we saw average electricity sales price increase together with the electricity sales revenues. The rise in average electricity sales price comes for bigger share of retail sales volume as the average price of retail contracts is higher than the electricity prices on the wholesale markets. Secondly, Narva power plants aim for electricity production during peak hours when the electricity prices are higher. Despite favourable dynamics of peak hours, the total electricity generation fell by 39% compared to 2018. The decrease comes from oil shale production units due to high CO2 prices and the unexpected guarantee maintenance of our newest power plant Auvere. During the whole year, Auvere was available for operations only for 4 and a half months. At the same time renewable and alternative energy production has continued to increase, led by wind. For the whole year, energy produced from renewable and alternative resources constituted 36% of total energy production, for example in December the figure was even as high as 60% on the back of good wind conditions.

The dynamics that we saw in 2019 can be summed up in the following way: oil shale energy production is decreasing due to high CO2 prices, but that is being compensated to some extent by the subsidized renewable production; retail sales portfolio continues to increase which is in line with the Group's strategy. Electricity sales volumes lay out the same idea in numbers: wholesale sales have decreased by half to 1.1 TWh, while retail sales increased by 0.9 TWh led by increased sales in Sweden, Finland, Latvia, Lithuania, and Poland.

Turning to the next slide, the EBITDA of the electricity segment increased by 1.6 million euros to nearly 133 million euros. When taking a closer look at the EBITDA developments, the movements were diverse. Despite higher electricity purchasing costs, electricity margins continued to improve including also a gain from sale of surplus CO2 emission allowances in accordance with the hedging strategy. In 2019 we produced less electricity than previously hedged, which meant that during the course of the year we adjusted the surplus CO2 positions to the actual need by selling the surplus CO2 quotas.

Lower sales volumes and change in the value of derivative instruments had a negative impact on the EBITDA on a yearly comparison basis, whereas gain on derivatives and fixed costs in the oil-shale related Large-scale Energy Production had a positive effect. Fixed costs in the Renewable Energy unit increased due to the acquisition of Nelja Energia in November 2018, while fixed cost increase in Customer Services is related to increasing the Group's footprint in our home markets near the Baltic Sea.

Now, let's go to slide number 11, where we will cover the performance of the distribution segment. As a result of the regulated tariff decline in January 2019, the average distribution sales price and sales revenues in 2019 fell by the same magnitude. The distribution volume was roughly on the same level. Network losses continued to decrease and were at the level of 4.1% of electricity entered into the distribution network. The same figure was 4.3% the year before. However, due to stormy fourth quarter we saw the average duration of unplanned interruptions rocket for the whole year, while in the first nine months we were ahead of the 2018 figure.

Moving on to the next slide, slide 12, it can be seen that EBITDA of the distribution segment was affected mostly by the tariff cuts, making up most of the EBITDA decline. For the whole year, EBITDA declined by 20% to 79.7 million euros. The slight decline in the distributed volume had its effect here, as did the higher fixed costs related to higher maintenance costs due to the stormy weather in the fourth quarter of last year.

On slide 14 we continue the overview of the results with the shale oil segment. In line with global oil prices, Eesti Energia's average shale oil sales price, excluding the impact of hedges, increased by 5.2% last year to 348 euros per ton. Taking into account the effect from hedged positions, the average sales price in 2019 was 60 euros per ton smaller as the hedged positions have been entered into at lower price levels compared to the current market prices. Good demand for our oil products together with increased production capability and favourable price trends during last year helped to increase the shale oil sales revenues by 10.8% from the 2018 figures.

2019 was another year for record oil production with 442 thousand tons, 7.8% more than in 2018. The previous annual production record of 411 thousand tons originated from 2018. In 2019 we saw the yield of our Enefit 280 oil plant at better levels than anticipated in its investment project forecasts throughout the whole year on a regular basis. This gives us good confidence to carry on with preparations regarding the investment into the new oil plant.

Turning to the slide number 15, let's continue with the profitability of the shale oil segment. The majority of the growth in shale oil EBITDA was due to higher market prices of oil and better volumes. However, gain on derivatives balanced off the impact from the positive market price movements. Another negative factor was the fixed costs resulting from the allocation of payroll costs. The majority of the increase in payroll was related to the mining unit as higher volumes of oil shale are used for oil production, and less for electricity production. It could be said that essentially these payroll costs are variable from the perspective of the oil segment, as they relate to higher production volumes, despite being shown under fixed costs in line with the Group perspective.

On slide 16, let's cover the contribution of other products and services of Eesti Energia Group. Sales of such other products and services reached 107 million euros in 2019, an increase of 26%. The growth was largely driven by sale of pellets as together with Nelja Energia in November 2018 we also acquired a pellet factory in Latvia. Sales of natural gas and mining products also increased, while heat sales have come down. Turning attention to the EBITDA of other products and services, the main factors compared to 2018 were the Auvere power plant's liquidated damages which we no longer received in 2019, and a reduction in heat sales that carried their way through to the EBITDA line. Under the 1.9 million euro EBITDA contribution marked as ''Other" on the slides we have grouped together smaller impacts, such as the EBITDA from the acquired pellet operations and from sales of some land assets.

Now, let's turn attention to the development of cash flows in 2019. On slide 17 there is a graph which shows the steps from EBITDA to operating cash flow. The Group's EBITDA was 259,8 million euros in 2019, while operating cash flows amounted to 147.6 million euros. The gap between EBITDA and operating cash flows comes mostly from increase in working capital, interest payments and income tax. Working capital was influenced by increases in current receivables as electricity retail sales volumes continue to increase. Inventories, related to oil shale, pellet and biofuel, also increased having a negative effect on the cash flows, as did the current liabilities. Settlements related to the CO2 emission allowances increased operating cash flow relative to EBITDA by 19.4 million euros as in net terms we paid less cash for CO2 emission allowances compared to the CO2 related expense in the Income Statement. The effects from the before-mentioned sales of the CO2 quotas to match hedges with actual production quantities are also included here. Additional cash flow adjustments related to derivative instruments excluding CO2 emissions amounted to a negative of 7.9 million euros. The impact from shale oil hedges was negative as oil hedges were made on lower price levels than current market prices. Electricity hedges had a positive impact in 2019. Interest payments amounted to nearly 25 million euros, income tax was 17,2 million euros as a result of the 2019 dividend payment of 57 million euros to the owner, and also due to the fact that income tax on the 2018 dividends was paid in the beginning of 2019.

Next let's continue to slide 18 where operating cash flow of 2019 is compared to that from a year earlier. The group's operating cash flow declined by 11% in 2019 compared to the year before. Majority of the decrease came from working capital movements. The factors behind the negative change in working capital include decrease in the accounts payable related mostly to taxes and sums paid to third party contractor's, while we also saw inventories slightly increase. The next biggest contributor was the lower EBITDA followed by higher income tax paid related to the dividend payments to the owner. When comparing 2018 and 2019 cash flows, impacts from derivative instruments, including impact from the CO2 transactions were positive. Interest payments in 2019 were lower than in 2018 as in September 2018 we redeemed the outstanding bond with a coupon rate of 4.25% from cash reserves.

Moving on to slide 19, let us also look at Eesti Energia's investment cash flow in 2019. The group's capex declined to 136 million euros, down by nearly one third compared to 2018. The largest component in the total capex still continues to be the distribution network with ca 83 million euros. Maintenance investments to the rest of the business amounted to 35 million euros, down by 9 million euros from 2018 as the oil-shale related electricity production together with mining operations have decreased. Development investments also decreased during the year, as 2018 saw Auvere power plant related payments, which are no longer there. Still, we continue to invest in technologies that enable us to expand our footprint in the use of renewable and alternative energy resources, such as the wood shredding complex and of course different renewable development projects.

On the next slide, slide number 20, we have provided an overview of the group's liquidity position. At the end of 2019 Eesti Energia's cash balance amounted to 34.6 million euros. Undrawn liquidity facilities amounted to 425 million euros, consisting of 250 million euros of revolving credit facilities with local commercial banks, and of 175-million-euro loan agreement with the EIB that was signed in December 2019 and has not been taken into use. During the first quarter of 2019, we carried through refinancing in our Enefit Green subsidiary, and took out new loans that we had signed in December 2018 after acquiring Nelja Energia.

On slide 21 let's have a look at the group's leverage ratios and repayment profile. As a result of the renewable acquisition which closed in November 2018, Eesti Energia's net debt to EBITDA ratio increased to 3.7 times by the end of 2018 and continued to increase in 2019 to 4.2 times by the end of the year. This level characterizes the tough operating environment for the oil shale electricity production that we saw in 2019. The metric also exceeds the group's long term financial policy target of 3.5 times net debt to EBITDA. The Group has outlined measures to get back to the financial policy metric. The debt maturity profile outlined in the lower part of the slide shows repayments of loans that the group had as at the end of 2019.

On the next slide number 22, let's discuss the outlook for Eesti Energia for 2020. It is the management's expectation that the group's sales revenues, EBITDA and investments are likely to grow in 2020 compared to 2019. The Group's electricity sales revenue and EBITDA should be supported by relatively high electricity prices but higher cost of carbon emission allowances will have an adverse effect on the group. We expect that shale oil revenue and EBITDA will be supported by growing demand for our products, which will increase the average sales price of shale oil. Electricity distribution revenue and EBITDA are expected to remain at a level comparable to 2019. Revenue growth will be supported by the sale of new ancillary services.

Investments are forecasted to grow primarily due to investments in renewable energy projects, while the new oil plant related investments will remain modest in 2020. Dividends are expected to be at a level of 23.2 million euros in 2019 on top of which there will be income tax.

To conclude today's presentation, 2019 was a year full of challenges for our oil shale related electricity production due to high CO2 prices and relatively low corresponding electricity prices. During the course of the year we received a specific order from our owner, the state of Estonia, to keep operation ready 1000MW of oil shale based production units until 2023. Still, shale oil production units are working nicely and the renewable business had quite a year. The distribution business saw declining revenues and profits due to the diminishing allowed profitability by the Competition Authority which is the direct consequence of the low interest-rate environment created by the world's central banks. As a counter step, we are in the middle of developing the market-based services at the distribution business, such as the high-speed internet infrastructure and the public street lightning projects. We look forward to 2020 with full anticipation and are now ready to take your questions.

Thank you for listening our 2019 results call. 2020 1st quarter results call will be at the end of April. Thank you.