Eesti Energia Unaudited Financial Results for Q1 2020

5 May 2020
Transcription

Andri Avila

Dear investors and partners, my name is Andri Avila, the CFO of Eesti Energia. I am glad to welcome you to our regular conference call to discuss Eesti Energia's first quarter 2020 financial results. I hope you have had a chance to download the quarterly report and the investor presentation from our web site.

To start off, from slide number 3, in the 1st quarter of 2020 Eesti Energia's sales revenues decreased by 16.5% to 226.8 million euros. At the same time group EBITDA decreased by 41% to 49.7 million euros. The decline in both revenues and EBITDA can be tracked down to the electricity segment, as the Nordic power prices were at low levels due to warmer than usual first quarter weather. From the month of March, the Corona epidemic played its part in the decline of the overall electricity consumption volumes, thus pushing the regional power prices even lower. Operating cash flow amounted to -1.1 million euros, down by 104 million euros mostly due to lower EBITDA and cash outflows related to derivative instruments. The Group's capital expenditure in the second quarter amounted to 68.7 million euros which is more than three times higher than a year ago. The rise in capex came from the acquisition of land for the development of Tootsi wind park. We will review the financials in more detail in the upcoming slides.

Before we move to the financials of the business segments, let's cover the developments of our main commodity markets on slide number 4. Compared to last year, first quarter electricity prices in the Nord Pool region were 40 to 60 percent lower than a year ago due to warmer than usual weather which led to lower electricity demand together with the effects from the Corona epidemic. Also, the Nordic hydro levels are higher from their historical 20-year median reference level providing support to the low electricity price environment in the Nordics and Baltics. As a consequence, electricity prices in the Baltics were lower by ca 42% compared to last year's first quarter, in Finland by nearly 50%, and in the hydro-dependent Sweden and Norway more than 60% lower. At the same time electricity price in the coal intensive Polish electricity market was more stable compared to the Nordics, with first quarter electricity prices falling by roughly 20% year-over-year.

During the first quarter price spread between Estonia and Finland increased by 3.4 euros per MWh. As a result, electricity price during first quarter of this year in Estonia was on average 3.6 euros per MWh more expensive than in Finland. The price spread indicates that the interconnection capacities between Estonia and Finland were not sufficient in the first quarter to balance off the price spreads between the two countries. The price spread between Estonia and Latvia was non-existent, continuing the trend from previous quarters.

Lastly on this slide, a few comments on the clean dark spread, which has declined to unseen territory of –22.5 euros per MWh. The metric clean dark spread shows the available margin to electricity producing oil shale based power units considering market prices of electricity and CO2, and also internal oil-shale related costs. However, in the Income Statement we use the average reserve price of CO2 which is lower than the market price of CO2 due to free allowances and hedge transactions from previous periods. Majority of the decrease in the clean dark spread came from the lower electricity price, while oil shale related costs were higher as the overall mining volumes were lower, thus the increase in per unit cost.

On slide 5, let's cover the oil markets. In this year's first quarter we saw month-by-month decreasing oil prices. The quarter started with a price war between the Saudis and Russia, after which Corona took the market over putting nearly 2/3 of the world's population in lockdown. The lockdown has resulted in unprecedent low demand levels for oil products, with storage facilities reaching their limits. While the March average price for Brent crude oil was

33.9 dollars per barrel, the quarterly average price was significantly higher at 50.8 dollars per barrel. This is a fifth lower compared to prices from the same period a year ago. The 1% Sulphur content fuel oil price movements were comparable to the ones of Brent, but the movements were more restrained with prices falling by 10% for the quarter compared to levels from last year. In April we witnessed the WTI benchmark price go to negative territory. As the reference product for our oil products is Brent crude oil, therefore the negative WTI prices have no direct effect on our results. Going forward we see good support from regulations to the fuel oil market, as our products are fully in line with the International Maritime Organization's latest requirements for fuel quality.

Going to slide 6, let’s start the review of Eesti Energia’s financial results in more detail. Lower sales revenues and EBITDA can be tracked down to the Electricity segment, which we will shortly review in more detail. Despite falling revenues, distribution segment managed to show stable EBITDA compared to last year's figures. Shale oil segment supported positively both revenue and EBITDA numbers, while the contribution from other products and services was mixed.

On slides 8 and 9, let’s look at the results of the electricity segment in more detail. Although the electricity market prices decreased more than 40% in the first quarter of this year compared to previous year, the average electricity sales price of the Group decreased less as the larger share of retail sales has a supporting effect. Namely, the average price of retail contracts is higher than the electricity price on the wholesale markets. In total, the electricity sales volume amounted to 2.2TWh, a decrease of 14.3% led by lower wholesale volumes. On the wholesale markets the volume decreased by nearly 55% year-over-year. Despite retail electricity sales volume declining by 4.2% compared to last year, we saw higher volumes in Latvia and Lithuania. The electricity sales revenue fell by 35.6% as the electricity sales price and sold quantities decreased. Electricity generation of the group in the first quarter was at the level of 1TWh, which is more than a half lower from the figures of last year’s same period. The renewable electricity production gained from favourable weather conditions and good technical reliability of wind parks. The oil shale electricity production was affected directly by low levels of the electricity market price. Energy produced from renewable and alternative resources made up 61% of total energy produced during the quarter. This is above the 45% strategic target that the Group has communicated for the year 2023. Despite reaching the target already mainly due to decreased oil-shale electricity production, we are continuing the development of renewable projects in our home markets. The first quarter of 2020 goes down to history books as the first time Eesti Energia’s renewable electricity production exceeded the oil shale electricity production volume.

We have hedged electricity price risk for our power production units and for the retail sales business separately. For the remainder of the year we have power production hedges in place in the amount of 0.6TWh at an average price of 44.2 euros per MWh. As the spot market prices in the Nord Pool region tend to be very volatile, the idea of hedging power production is to fix the price of electricity sold to the market before the actual production of electricity occurs in order to have the assurance regarding the final sales price. For our electricity sales business we have hedges in the amount of 1.7TWh for the remainder of this year and in the amount of 2.2TWh for next year. The logic behind electricity sales hedges is to fix the price of those electricity contracts where we have sold electricity at a fixed price to our customers. The information regarding hedged positions has been outlined also on slide number 26.

Turning to slide number 9, EBITDA profit of the segment declined by 31.9 million euros from last year's levels. Lower electricity sales price had the largest negative impact on EBITDA, which on the graph is shown under the margin impact. As the share of retail sales volume increases, we are also witnessing higher electricity purchasing costs, on the graph this item is also included under margin impact. Smaller sales volume quantities also impacted EBITDA negatively, as did gain on derivatives and change in the value of derivative instruments. On the positive side we saw lower maintenance and payroll costs as a result of lower oil shale electricity production quantities.

To provide more insight, currently three different business areas are covered under the same product segment of electricity – first, renewable electricity production; secondly, retail sales of client services business; and third, the electricity production from oil shale. Those three businesses are vastly different in their dynamics. EBITDA from renewable electricity production amounted to 28 million euros in the first quarter, same level as the year before. The EBITDA of the oil-shale electricity production declined by 33 million euros in the first quarter to an EBITDA loss of 6 million euros.

Next on slide 11, let’s look at the results of the distribution segment. Distribution volumes were 4.5% lower than a year ago in the first quarter as the electricity demand was weaker due to warmer than usual weather and the decreased economic activity as the result of the lockdown. As the distribution tariffs were on the same level as a year ago, the sales revenue was affected solely by the lower consumption volumes and declined year-over-year 4.5%. Network losses were at 3.92% compared to a level of 4.02% a year ago, impacting the distribution segment's results positively. Despite the sudden economic downturn, we have not witnessed a slowdown in the application numbers of new connections which are on a higher level compared to two previous years.

Moving to slide 12, EBITDA of the distribution segment increased by 0.1 million euros. Lower network losses had a 2.1m euro positive impact mitigating the effect from lower distribution volumes Fixed costs were higher from a year ago as some maintenance works from the stormy fourth quarter of last year were finished in the beginning of this year.

Starting from slide 14, let's cover the shale oil segment. Although the average sales price of shale oil decreased in accordance with the lower world market prices, we saw the sales revenue of the oil segment rise by 17.7% from last year's levels as the impact from hedging activities had a positive effect. Shale oil sales volume was basically on the same level as last year by increasing 0.4%. The reason for the 2.2% decrease in oil production quantities is different maintenance schedule from last year, as this year we moved maintenances to a bit earlier compared to last year. For the remainder of 2020 we have hedged the majority of the oil production, 345 thousand tons, at an average price of 318.2 euros per ton. For next year we have hedged 283 thousand tons of oil at an average price of 315.3 euros per ton, which is roughly 2/3 of our annual sales and production volume.

On the next slide let’s look at the profitability of the shale oil segment. The growth in shale oil EBITDA was due to gain on derivatives as the world oil market prices came down, with hedging instruments fulfilling their purposes of providing shelter in such circumstances. The small increase in sales volumes of 0.4% translated into a minimal positive impact on EBITDA of 0.1 million euros. Negative impacts to EBITDA came from lower world oil market prices and fixed costs, as the share of internal mining costs attributable to shale oil segment has increased.

To finish off the performance of the first quarter, let’s cover the contribution from other products and services on slide 16. The increase in sales revenues came mainly from higher gas and pellet sales. Although gas sales increased, we saw negative EBITDA effect due to unfavourable gas market price movements as currently gas transactions are not included under hedge accounting framework, thus affecting the income statement on a monthly basis. Intention is to introduce gas hedge accounting framework under IFRS9 this year. The biggest impact came from heat sales and heat EBITDA which declined by 3 and 4 million euros respectively compared to last year first quarter numbers.

Turning on to slide 17, the development of Eesti Energia's cash flows in the first quarter of 2020 is shown as steps from EBITDA. The biggest factors affecting the operating cash flows were changes in working capital and derivative instruments. Under working capital, biggest impacts came from three places. First, oil and oil shale inventory increased. Secondly, during the quarter there were higher tax prepayments associated to the purchase of Tootsi development land. And thirdly, collaterals provided to partners as guarantees for hedging transactions increased. The next biggest column, derivative instruments, includes cash impact from already existing oil, gas and electricity hedge transactions. The movements here were in different directions during the quarter with electricity transactions seeing cash outflows, while oil and gas related hedge transactions ended up in cash inflows, resulting in total outflows of 19.6 million euros. The column CO2 impact includes effects from mark-to-market of CO2 positions and CO2 related income-statement provisions based on actual allowances. The total effect here was –2.8 million euros. The CO2 provisions have a positive effect on cash flows as the related cost is accounted, but the actual cash outflow for the purchase of quotas usually happens once a year in the fourth quarter. The negative effect in the CO2 impact came from group's CO2 positions under future contracts that are settled daily for market price changes as the market price of CO2 quotas declined circa 7 euros per ton during the quarter. Other impacts related to interest or income tax paid were smaller. As a result, the operating cash flows during the quarter were –1.1 million euros.

On the next slide, number 18, let's compare the operating cash flows from previous year to this year. The biggest changes came from lower EBITDA, CO2, derivative instruments, and working capital. EBITDA impacts we have already covered. Negative CO2 impact compared to last year's same period has different reasons. First, smaller provisions were made during this year's first quarter as a direct consequence of lower power production quantities related to oil-shale electricity production, thus having a less positive effect on cash flows. Secondly, the decreased CO2 price had a more negative effect compared to last year as the CO2 market price decreased more during this year's first quarter while the amount of CO2 related future contracts subject to the daily settlement of CO2 market price owned by the Group was higher this year.

Similar to last slide, the movements of derivative instruments were in different directions. Electricity related derivative instruments resulted in more cash outflows this year, while oil and gas related instruments had a positive impact compared to last year. Still, the result was that during this year's first quarter the group had 27.3 million euros of more cash outflows related to derivative transactions compared to the last year figure. The working capital changes mainly relate to the same items as mentioned on last slide, the tax prepayments and increase in collaterals provided to partners as guarantees for hedging transactions. Income tax item had a positive effect, as a year ago income tax related to dividend payment concluded in December 2018 was paid in January 2019, whereas in this year no such item occurred as the dividend income tax was paid in 2019.

Moving on to slide 19, let's also look at Eesti Energia's investment cash flow from the last quarter. The group's capex reached 69 million euros. The largest component in the total capex, 43 million euros, was the purchase of the depleted Tootsi peat extraction site. Now we can move on with the development of the Tootsi wind farm project to increase the renewable energy production capacity of the Group. Other investment items were in more comparable figures to the previous periods, with investments into electricity network increasing by 6.1% to 16.2 million euros, and other maintenance investments amounting to 5.9 million euros. From this 2.2 million euros was invested in acquiring a hole drilling machine that helps to increase the occupational safety and optimise costs through mechanising processes.

On slide 20 an overview of the group's liquidity position has been provided. At the end of March this year, Eesti Energia's cash position amounted to 53.5 million euros. In addition, the group had access to revolving credit facilities in the amount of 150 million euros, and an unused long-term loan agreement in the amount of 175 million euros from the European Investment Bank providing sufficient buffer for the outstanding eurobond maturing in November.

On slide 21 the group's leverage ratios and repayment profile has been provided. Eesti Energia's credit ratings are Baa3 from Moody's and BBB- from Standard and Poor's, both with stable outlook. Company's net debt to EBITDA ratio stood at 5.2x at the end of the quarter. The first quarter net debt to EBITDA ratio adjusted with the 125-million-euro equity injection by the owner that took place right after the end of the quarter, would be 4.65x. This figure is still above 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. Eesti Energia's financial policy is aimed at maintaining investment grade credit rating.

Finally, on slide 22, let's discuss the updated outlook for Eesti Energia for 2020. It is the management's expectation that the group's sales revenues and EBITDA are likely to decline in 2020 due to the effects of the coronavirus and lower prices of the power markets. The group's management is actively monitoring the environment to be ready for necessary adjustments. Electricity revenue and EBITDA are expected to fall due to the low electricity market price. Shale oil revenue and EBITDA are forecasted to decrease as the demand for oil products has temporarily declined and the oil market prices have dropped significantly. Distribution service revenue and EBITDA are expected to remain at a level of last year. Investments are expected to grow from the levels of last year, however due to the current uncertain environment those plans will be specified in more detail in the coming months. Currently it is expected that increase will come from renewable development investments, while at this time no major renewable development investment decisions have been made. Investments regarding oil shale sector are expected to decrease significantly. The oil shale related investments are expected to increase next year, as the investments regarding the new shale oil plant Enefit-280 will have a larger effect.

Turning to the last slide of today's presentation, let's summarise first quarter of this year. During the first three months we witnessed steadily low electricity prices. From March the effects from lower consumption due to lockdown measures also kicked in. This led to lower electricity segments sales revenue and EBITDA. Although oil prices declined during the quarter, hedge transactions provided shelter with both shale oil revenues and EBITDA showing gains. Distribution segment was affected by lower consumption volumes, but better operating efficiency with network losses led to slight increase of EBITDA. Investments grew due to the purchase of the depleted Tootsi peat extraction site which will be used for renewable project development. The quarter ended with a net loss of 2 million euros. With regards to distributions to the owner, the annual general meeting decided not to take out dividends this year. This is all from our side regarding the overview of the first quarter results, we are now ready to take your questions.

Thank you for participating in the investor results presentation. We hope to see you again at the end of July during our 2nd quarter results presentation. Thank you and stay safe.