Eesti Energia Unaudited Financial Results for Q2 2020

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Transcription

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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 second quarter 2020 financial results. I hope you have had a chance to download the quarterly report and the investor presentation from our web site.

Starting with slide number 3, we have provided a brief overview of the results before moving to the more detailed view. In the second quarter of 2020 Eesti Energia's sales revenues decreased by 17.8% to 168 million euros. At the same time group EBITDA decreased to a lesser extent, by 13% to 54.8 million euros. Like in the first quarter, the decline in both revenues and EBITDA mostly comes from the electricity segment, as the Nordic power prices continued at low levels on the back of above historical average hydro reservoir levels in Norway and Sweden. Operating cash flow amounted to 91.7 million euros, up significantly compared to last year's second quarter or to previous quarter. The Group's capital expenditure in the second quarter was nearly a third lower from last year's figures amounting to 28.1 million euros. Before covering the financial results of the business segments, let's take a look at the developments of our main commodity markets on the next slides.

On slide number 4 we have provided an overview of the electricity market. As was the case in the first quarter, electricity prices are continuing at very low levels in the NordPool area. It is hard to estimate how much the restrictions implied by governments have played part in the low electricity prices as the overall consumption volumes have fallen, but the currently low electricity price environment looks rather to be the result of high hydro reservoir levels in Norway and Sweden. In the hydro heavy regions electricity prices fell to unseen levels of below 10 euros per MWh for the whole second quarter. The average electricity prices in Finland and Estonia hovered around 20 to 30 euros per MWh. Those levels are around a third lower from last year's second quarter figures. Also, during the quarter for the first time in history the Baltic countries witnessed intraday negative electricity prices. At the same time the monthly average electricity price in June is the highest monthly electricity price seen so far this year for Finland and the Baltic countries. In the Baltics there were a couple of days in June where the average daily electricity price approached 100 euros per MWh, with intraday hourly prices exceeding 200 euros per MWh. This is also the reason why the red line on the graph, which is the average electricity price achieved by Eesti Energia Power Plants, is significantly higher from the average electricity market price because Narva power plants produced electricity mostly during peak hours. Due to maintenances and congestions of the interconnection cables, electricity price differences in the region increased both on a quarterly and yearly comparison. Price spread between Estonia and Finland in the second quarter was at its highest since 2012, at 6.3 euros per MWh.

The clean dark spread has continued declining and is now at the level of -26.7 euros per MWh due to low electricity ang high CO_2 price. Oil shale related inner costs were higher due to lower mining volumes, thus increasing the costs. However it should be kept in mind that this figure on the graph is purely market price based with regards to electricity and CO_2 components, while in the Income Statement the average reserve price of CO2 is used and this is lower from the market price due to received free allowances and past CO2 hedges made from lower price levels.

On the next slide, let's briefly cover the oil markets. Although second quarter's average prices for Brent crude oil and 1% Sulphur content fuel oil decreased by slightly more than half in yearly comparison, we saw recovering prices on a monthly basis. Due to different measures to keep the Covid-19 pandemic under control, nearly 2/3 of the world population was at some point under moving restrictions, thus having a significant impact on the demand side. Still, most of the analysts expect no significant changes to the long-term outlook of oil demand, however in the short term we can have a bumpy ride depending on how the Covid-19 pandemic situation develops.

On slide number 6, we have provided an overview of how Covid-19 pandemic has impacted Eesti Energia. Entering the Covid-19 pandemic it was company's expectation that distribution volumes would decline about 5% during this year. So far, we have seen 6-month distribution volumes fall 4,4% from last year, however most of the decrease came in January due to warmer than usual winter weather. With regards to electricity and gas volumes of retail sales, slight decreases were expected. Yet, in the gas market we have managed to gain market share, while electricity sales activity is within expectations. The big unknown entering the emergency situation was the customer payment behaviour, but so far we can say that we have not witnessed a rise in overdue invoices. In addition, we have seen the procurement price levels coming down slightly, therefore we expect some savings on procured costs going onward. All in all, we are within the expectations, however we keep monitoring the circumstances and if needed we are ready to make additional adjustments.

Turning to slide number 7, let's start the review of Eesti Energia's financial results. The major cause for the lower sales revenues and EBITDA is the Electricity segment. Distribution segment managed to show stable EBITDA, despite a small decline in sales revenues. Shale oil segment's sales revenue was impacted by low market prices and lower quarterly sales volumes. The effect from oil hedges made from higher price levels provided support to oil EBITDA number, therefore the smaller decrease in shale oil's EBITDA compared to shale oil's sales revenues. Other products and services contributed positively to sales revenues and EBITDA, while income from the sale of excess CO2 positions is included under EBITDA of other activities.

From slide number 9, let's start the overview of the electricity segment. While the electricity market prices decreased by roughly a third in the second quarter, the Group's average electricity sales price decreased less, because the larger share of retail sales, where the margins are higher, has a supporting effect together with electricity production by Narva Power Plants during peak hours. Electricity sales volume decreased led by smaller retail sales quantities due to Covid-19 pandemic implications while wholesale quantities showed modest increase. As a result of lower electricity prices and sales volumes together with negative impact from derivative transactions, the quarterly electricity sales revenue fell on a yearly basis by nearly a third.

Across markets, the picture regarding volumes was mixed – we saw declining electricity volumes in Estonia, Latvia and Poland, while in Lithuania electricity sales volumes increased. Electricity generation of the group in the second quarter amounted to 0.6 TWh which is nearly a half lower on a yearly comparison basis. The reason here is the low electricity market price environment caused by high hydro reservoir levels in the Nordics together with the high CO2 price which does not give much room for Narva Power Plants to operate. Renewable energy production carried on from where it ended the first quarter. Favourable weather conditions together with good reliability of renewable production assets helped to pave a way for another set of renewable production records. Electricity produced from renewable and alternative resources made up 63% of total electricity production during the quarter, which is above the Group's target of 45% for 2023 for a fourth quarter in a row. Despite reaching the target on the back of decreased oil-shale electricity production, we are continuing the development of renewable projects in our home markets to further improve the company's asset base. During the first half of the year, we have produced 46% of electricity from directly renewable resources, and 62% while taking into account also alternative resources together with the renewable ones. We have hedged electricity price risk for our power production units and for the retail sales business separately. A more detailed view regarding hedged positions can be seen on slide number 27 in the appendices.

Continuing on slide number 10, the EBITDA profit of the electricity segment was 8 million euros, a decline of 24 million euros from last year's levels. Most of the EBITDA decrease can be tracked down to two items. First, the impact from lower sales price is shown under „Margin impact" on the graph together with variable costs which have increased due to higher electricity purchasing costs as a smaller proportion of net sales volume is sourced from own production because of smaller electricity production quantities. Secondly, another bigger item was „Gain on derivatives" due to realized electricity derivatives that had a negative effect. To cover other impacts, the 8.4% reduction in sales volumes had an effect of -3.8 million euros to EBITDA, while other changes also impacted the EBITDA negatively in the amount of 2.5 million euros, mostly related to change in the value of derivative instruments. On a positive note we managed to keep the overheads under control which is illustrated by a nearly 5 million euro decrease in fixed costs.

Next on slide 12, let's cover the results of the distribution segment. Distribution volumes in the second quarter were 3.4% lower on annual basis, while in the first quarter the decrease was even larger, 4.5%. Therefore, it can be said that the warmer weather of the first quarter had more effect on distributed volumes than did the restrictions on people and businesses imposed by the authorities as a response to the Covid-19 pandemic. The average distribution sales price, the tariff, increased by 2.7% due to changes in the consumption profile. As a result of Covid-19 pandemic we saw consumption by business clients drop while household electricity consumption slightly increased. Since the household tariffs are higher than the tariffs for business clients there was a rise in the average tariff. The sales revenue of distribution unit fell by 0.8% from last year's figures as the lower distributed volume outweighed the slight increase in average sales price. Although network losses increased slightly to the level of 4.18%, the total effect from the network losses to the EBITDA line was positive compared to the previous year due to lower electricity purchasing costs as a result of lower electricity market prices. The average duration of unplanned interruptions grew slightly as this year’s second quarter witnessed a couple of heavy storms while last year’s spring was more calm.

Moving on to slide number 13, EBITDA of the distribution segment in the second quarter was at 23 million euros, on the same level as a year ago. Still, under the cover there were some changes worth mentioning. As touched upon on the previous slide, network losses had a positive impact, while negative effects came from lower distributed volumes and higher costs associated to maintenances due to strong winds and storms witnessed during the quarter. On a positive note, despite the rise in unplanned interruptions, we saw decline in the duration of planned interruptions.

Next, we continue with the shale oil segment, so please kindly turn to slide number 15. The quarterly average sales price of shale oil decreased due to the declining oil market prices, while derivative transactions made from higher price levels had a supporting effect. With regards to sales volumes, our sales contracts allow to adjust sales quantities in case of low market prices, thus the decrease in sales volumes during the quarter. We also adjusted the maintenance schedule of our oil plants by bringing some scheduled maintenances forward in the first quarter and those planned maintenances carried out on to the second quarter, therefore the fall in quarterly productions volumes which was about 27 000 tonnes. Despite the Covid-19 pandemic impact, we see good demand for our oil products mostly due to the support from regulations of the fuel market, as our products are fully in line with the International Maritime Organization's latest requirements for fuel quality.

For the remaining 6 months of 2020 we have hedged the majority of the oil production, and for the next year roughly 2/3 of annual sales and production volume is hedged. We have provided the same information on slide 28 in the appendices.

On slide number 16, the overview of profitability of the shale oil segment is provided. The decline in shale oil EBITDA on a yearly basis comes from two factors outlined also on the previous slide – lower average sales price together with fallen sales volumes effected EBITDA negatively while derivative transactions had a supporting effect. The huge difference in the derivatives from the figures of last year is due to the difference in the oil market price environment. In previous year’s second quarter the oil market prices were above our hedging levels resulting in losses, whereas this year we have an exactly opposite situation – our hedges are made at price levels well above current prices resulting in profits. As mentioned on the previous slide, the flexibility of our sales contracts allows us to adjust sales quantities in the low market price environment, thus we took advantage of the low oil market price environment and closed some positions of this year’s hedges before the maturity deadlines of the derivative contracts to lock the profit. As to the last uncommented item, fixed costs, we can say that the positive effect was the result of overall lower costs across the spectrum, no specific items to outline here.

And as usually, we finish off the overview of segments with the performance of other products and services, so please turn to slide number 17. The increase in sales revenues came mainly from higher gas and heat sales. Despite better heat sales, EBITDA impact from heat was negative. Previously oil shale was largely used as a heating fuel, but now as the Narva Power Plants are working less of a time, other sources are used as a fuel resulting in additional costs compared to previous periods. Gas sales had a positive impact on the EBITDA line, with some of the gain coming from the changes in the value of derivative instruments. Currently gas derivatives are not included under hedge accounting framework, thus affecting the Income Statement as gas market prices change. Our goal is to apply accounting framework under IFRS9 to gas derivatives still this year. Other changes in EBITDA, the 13.5-million-euro item on the graph, mostly consists of the income from the sale of excess CO2 emission allowances to adjust the group's long position in CO2 emissions to neutral. Previously we have shown similar item under Electricity segment, but as those specific CO2 emission allowances were under heat production, we have also shown the income under the EBITDA of other products and services.

To cover the cash flow development from EBITDA in the second quarter, please turn to slide number 18. Positive contribution to the strong operating cash flows came mainly from CO2 and derivative instruments. CO2 impact covers effects from mark-to-market of CO2 positions that illustrate the CO2 market price movement during the second quarter, and also CO2 related income-statement provisions based on actual allowances. Both those items in the quarter had a positive effect. The CO2 provisions usually have a positive effect on the cash flows as the related cost is accounted in the Income Statement, but the actual cash outflow for the purchase of the quotas usually happens once a year in the fourth quarter. In the derivatives, both oil and electricity instruments had a positive impact. To comment on the working capital changes, then this item was led by seasonal increase in inventories as we made gas purchases in the low season and produced pellets to be ready for the winter sales season in both markets. Although the effect from payables and receivables was positive in the amount of ca 5.5 million euros, the change in inventories dragged the working capital changes to negative territory.

On the next slide, we have provided a comparison of operating cash flows in the second quarter of this year's second quarter versus second quarter of 2019. The biggest change came from CO2 and derivative instruments, whereas a working capital changes also had a positive impact together with the income tax as this year there was no dividend payment. Larger CO2 impact illustrates that during the year's second quarter CO2 prices rose more than last year, also the CO2 related provisions were larger this year. Cash flows related to derivative instruments were more positive this year, both from electricity and oil, while gas related instruments saw small outflow.

At the end of June, Eesti Energia's cash position amounted to 134.4 million euros. During the second quarter Eesti Energia received the share capital pay in from the owner in the amount of 125 million euros decided in the month of March. During the quarter some credit lines that were in use were returned as the operating cash flows were strong during the quarter. As of the end of second quarter, Eesti Energia had access to revolving credit facilities in the amount of 295 million euros, and unused long-term loan agreements from the European Investment Bank in the amount of 245 million euros. During the quarter we signed three loan agreements. The biggest one was long term loan agreement with the European Investment Bank in the amount of 70 million euros, and also there were two smaller loan agreements under Enefit Green. One agreement was with EBRD in the amount of 40 million Polish zloty that was taken into use during the quarter. The second agreement was a 25-million-euro revolving credit facility signed with SEB Estonia. More information regarding the loans can be found in our interim report and on our home page under Investor News.

And now one slide back to capital expenditure, Eesti Energia's investment related cash flow during the ended second quarter. The group's capex was at 28 million euros, declining by 30% from last year's levels. The biggest share of investments went to the electricity distribution network. Those investments are made mostly by Eesti Energia's subsidiary Elektrilevi and in essence these are base investments made to the distribution network to further improve the network quality by making the connections more weather-proof and building new connection points. During the quarter there were no notable bigger investments.

So let`s move now to slide 22, where we have provided an overview of the group's leverage ratios and debt repayment profile. Eesti Energia's credit ratings have not changed and they 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 4.5x at the end of the quarter, declining from the first quarter figure. Still, this figure is 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. There have been some minor changes to the debt repayment profile as a result of the 40 million Polish zloty EBRD loan disbursement. The debt maturity profile of the Group has been now extended until 2028.

Finally, on slide 23, let's cover the company's management outlook for the remainder of this year. The management outlook has not changed from the first quarter of this year. It is the management's expectation that the group's sales revenues and EBITDA are likely to decline in 2020 due to the effects from the Covid-19 pandemic. 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 lower 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 investments regarding the new shale oil plant Enefit-280 are forecasted to begin in 2021 pushing the oil-shale related investments once again higher.

Turning to the last slide of the presentation, let's summarize the second quarter of 2020. During the second quarter we saw the trends from the first three months of the year continue, illustrated by low electricity and oil prices. Although oil prices somewhat recovered by the end of second quarter, hedge transactions still continue to provide shelter for our oil shale operations. Distribution segment has been affected by lower consumption volumes, but better operating efficiency has helped to keep EBITDA stable. The second quarter ended with a net profit of 7 million euros. Overall, we can say that we are in a low market price environment with effects from the Covid-19 pandemic far from over. It is the management's assessment that the operations of the company thus far have been on a satisfactory level. We are monitoring the situation on our home markets carefully and are ready for additional adjustments where and if needed. We are now ready to take your questions.

Thank you for participating in the second quarter investor results presentation. Let's meet again at the end of October for our third quarter results presentation. Thank you and stay safe.