Eesti Energia Unaudited Financial Results for Q3 2020

29 October 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 third 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 from slide number 3, there is an overview of the third quarter before me move on to a more detailed view. In the third quarter of 2020 Eesti Energia's sales revenues decreased by 5.2% to 191.1 million euros. Group EBITDA however increased by 5.3% to 44.4 million euros. Like in the first half of the year, the decline in revenues mostly came from the electricity segment on the back of low electricity prices. Although the EBITDA of the electricity segment also fell on an annual basis, the performance from other segments, mainly from shale oil and distribution, was sufficient for EBITDA of the Group to increase. Operating cash flow was 73.5 million euros climbing significantly from last year's levels mainly due to positive cash flow impacts from working capital changes and derivative instruments. Capital expenditure increased to 35 million euros, a rise of 9.4%. Before covering the financial results of the business segments, we will take a look at the developments of our main commodity markets on the next slides.

Turning to slide number 4 we have provided an overview of the electricity market. Similar to the first six months of the year, electricity prices have continued at low levels in the NordPool area on the back of high Nordic hydro reservoir levels. Although on a quarterly basis, the average electricity prices in Finland and Estonia increased, they were still at least 25% lower from last year's levels. Also, we can say that the third quarter was a bit more peaceful in the context of the electricity market price, as there were no negative intraday electricity prices in the Baltics. Average quarterly electricity price spread between Estonia and Finland narrowed from previous quarter's 6.3 euros per MWh to 4.0 euros per MWh. At the same time price difference between Estonia and Latvia widened from 0.1 euros per MWh to 1.6 euros per MWh during the third quarter after 12 months of close to zero price differences between the two Baltic states. The average electricity price achieved by Eesti Energia Narva Power plants remained at higher levels compared to quarterly average Nord Pool market electricity prices as a result of peak-hour electricity production. The Clean Dark Spread decreased on an annual basis to 9.4 euros per MWh, however on a quarterly comparison there was a significant improvement from last quarter's -26.7 euros per MWh. Compared to the second quarter, NordPool Estonia's average electricity market price was higher and the cost of oil shale per MWh improved, while the average market price of CO_2 in the third quarter was 6.1 euros per ton higher than in the second quarter*. It should be kept in mind that the Clean Dark Spread is a purely market price based figure with regards to electricity and CO_2 components. In the Income Statement the average reserve price of CO_2 is used, and this is lower from the market price due to received free allowances and past CO_2 hedges made from lower price levels.

On the next slide, let's briefly cover the oil markets. On an annual comparison basis, both the Brent crude oil and 1% Sulphur content fuel oil, were at lower price levels, but compared to the second quarter of 2020 we saw increasing prices. Still, there is no denying that the oil market is under pressure due to decreased demand and unclear

outlook for the coming months amidst the Covid-19 pandemic. Although there have been agreements to limit oil production by the OPEC countries, the concerns regarding the recovery of the demand side seem to lead the oil prices worldwide. We still see that most of the analysts expect no significant change to the long-term outlook of oil demand, however in the short and medium term we can have a bumpy ride depending on how the Covid-19 pandemic situation develops.

On slide number 6, we have provided an update to the impacts of the Covid-19 pandemic. Entering the Covid-19 pandemic it was company's expectation that distribution volumes would decline 5% during this year. So far, we have seen 9-month distribution volumes fall 3% from last year, in the end of June the 6 month change figure was at -4.4%. With regards to electricity and gas volumes of retail sales, slight decreases were expected, and actual figures show that the expectations have materialized for electricity sales. In the gas market we have managed to gain market share, however at the same time we have seen some bigger gas consumers in Poland to decrease their consumption by a fifth from last year's levels. With regards to the current customer payment behavior, then this is similar to the situation before the Covid-19 pandemic. All in all, we are within the expectations, however we keep monitoring the circumstances and if needed we are ready for additional adjustments. During the quarter, Estonian central bank released an update of the GDP forecast for Estonia, which is now expected to be better for 2020, however the road to recovery will be prolonged.

Turning to slide number 7, let's start the review of Eesti Energia's financial results. The major cause for the lower sales revenues is the Electricity segment. Distribution segment managed to show rising EBITDA, despite a small decline in sales revenues. Shale oil segment's third quarter sales revenue was impacted by additional sales that were postponed from the second quarter of this year to the third quarter. As in the previous quarter, the effects from oil hedges made from higher price levels provided support to oil EBITDA. Other products and services showed smaller revenues, but EBITDA from other activities improved due to positive effect from gas hedges that do not fall under IFRS9 hedge accounting.

To continue with the overview of the electricity segment, please turn to slide number 9. Although the electricity market prices decreased by nearly 25% to just below 37 euros per MWh in the third quarter, the Group's average electricity sales price excluding impact from derivatives decreased less, by 8.3%, to 50.7 euros per MWh. Support to the average electricity price achieved by the Group came from retail sales that are with higher margins, and from electricity production by Narva Power Plants that is targeted towards peak hours. Derivatives had a negative impact of -2.1 euros per MWh on the average electricity sales price. As a result, the average electricity sales price including gain on derivatives was at 48,6 euros per MWh. However, as we separate our hedges between retail and power production activities, the effects there mixed with power production hedging having a positive effect and retail hedges a more negative one. Electricity sales volume decreased due to both smaller retail sales and wholesale quantities. 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 fifth from 105 million euros to 84 million euros.

Electricity generation of the group in the third quarter amounted to 1.1 TWh which is 21.4% higher than in the third quarter last year. Last year's third quarter electricity production was affected by the maintenance schedule, as this year there were no comparable events. Renewable energy production was strong, most of the increase came from higher use of biomass in Narva Power Plants, while wind conditions were also favorable together with good reliability of renewable production assets. Biomass usage as a fuel gives an edge over traditional oil shale in the production of electricity in Narva Power Plants, as there is no CO2 cost for the used biomass. The biomass used mainly in the Narva Power Plants is of low-quality, residuals from industrial production. Therefore, the price of the biomass is also lower compared to traditional pellets or other biomass alternatives. Electricity produced from renewable and alternative resources made up 45% of total electricity production during the quarter, in-line with the Group's target of 45% for 2023 for a fifth 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 9 months of this year, we have produced 55% of Group's electricity from renewable and alternative resources. 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 to slide number 10, the EBITDA profit of the electricity segment amounted to 3.7 million euros, a decline of 6.8 million euros from last year. Biggest impact came from lower sales volumes, while the already mentioned derivatives also had a negative effect that mostly came from retail hedges. Under margin impact we have gathered the effects from two components. Firstly, lower sales price that had a negative impact, and secondly, positive effects from variable costs mainly due to lower electricity purchasing costs on the back of higher intra-Group electricity production quantities. Lower fixed costs had a positive effect of 2 million euros, as maintenance and payroll related costs decreased.

Next, let's turn to slide 12 where we shall go over the results of the distribution segment. Distribution volumes in the third quarter were 1.8% lower on an annual basis, while in the first two quarters the decrease was larger, in the first quarter -4.5% and in the second quarter -3.4%. The average distribution sales price, the tariff, increased by 1.8% year-over-year due to changes in the consumption profile. As a result of the Covid-19 pandemic we have seen consumption by business clients in slight decline while household electricity consumption has slightly risen. Since the household tariffs are higher than the tariffs for business clients, we see a rise in the average tariff. As a result of higher average tariff, the sales revenue of distribution unit was basically stable at 48.5 million euros in the third quarter. The average duration of unplanned interruptions grew significantly as this year's third quarter was more stormy compared to last year's same period.

Moving on to the next slide, number 13, EBITDA of the distribution segment in the third quarter increased by 8.1% to 24.3 million euros led by higher average tariff and smaller costs related to the network losses. Smaller volume of distributed electricity had a negative impact, that was outweighed by smaller maintenance costs. The smaller

maintenance costs are the result of better price levels received from latest procurements where we have seen prices come down by 7 to 10 per cent. Maintenance costs are related to planned interruptions and do not cover costs related to unplanned interruptions. For the sake of clarity, the duration of unplanned interruptions did not increase due smaller allocated funds, but due to more stormy weather in the third quarter of this year. Also, we will see from the capex overview slide, the investments into the electricity network have risen.

Next let's turn to the shale oil segment, so let's continue from slide number 15. The dynamics here were the same as in the second quarter. The quarterly average sales price of shale oil decreased on an annual basis due to the declining oil market prices, while derivative transactions made from higher price levels had a supporting effect. Third quarter sales volume, and as a result the sales revenue, increased both by more than a third. This was the result of postponing sales from the second quarter to the third quarter. As mentioned in the second quarter results presentation, our shale oil sales contracts allow for adjustment of sales quantities in case of low market prices, and this is what we did in the second quarter to move the maintenance schedules earlier. Despite the Covid-19 pandemic impact, we see good demand for our oil products mostly due to the support from regulations of the fuel oil market, as our products are fully in line with the International Maritime Organization's latest requirements for fuel quality. For the remaining 3 months of 2020 we have hedged the majority of our oil production, and for the next year we made some additional hedges and now have roughly 70% of annual sales and production volume hedged. We have provided the same information in detail on slide number 28 in the appendices.

Moving to slide number 16, we have provided the overview of shale oil EBITDA development. As the case has been in the previous two quarters of this year, margin impact is negative due to decreased average sales price without the impact from derivative transactions, while gain on derivatives has an offsetting effect. The huge difference in the derivatives from last year's figures is due to the difference in the oil market price development. A year ago, the oil market prices were above our hedging levels resulting in losses, whereas this year we have an exactly opposite situation, as hedges are made at price levels well above current prices resulting in profits. Volume impact was positive due to additional sales in the third quarter that were delayed from the second quarter of this year. Negative impact of fixed costs tracks down to changes in the inventory, while payroll costs slightly decreased.

Now you may kindly turn to slide number 17 to cover the performance of other products and services. The decrease in sales revenues came mainly from lower pellet and mining product sales. Better gas sales helped to mitigate the fall in revenues to some extent, while EBITDA of other products and services increased due to change in the value of gas derivative instruments which do not fall 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.

Moving to slide number 18, we have provided an EBITDA to operating cash flow bridge. The major positive impacts came from CO2 and derivative instruments. Under CO2 impact most of the effect, 24.6 million euros, came from CO2 related income-statement

provisions based on actual allowances. The logic is that in the Income Statement the CO2 cost is accounted, but as during the quarter there are no buyouts of the CO2 quotas, there is a positive effect on the cash flows. Usually the buyout of the CO2 quotas takes place once a year, in the fourth quarter. During the quarter nearly half a million ton of CO2 quotas were added to the Group's CO2 position resulting in increased collateral of roughly 3.3 million euros. Since the price of CO2 emissions ended the third quarter pretty much where it started, near 27 euros per ton, there was no major effect from CO2 market price movements on third quarter cash flows, and the total impact from CO2 was about 21 million euros. Most of the positive effect of derivative instrument changes came from electricity related instruments in the Nordics and in Poland. In Poland we managed to substitute cash collaterals with bank guarantee resulting in lower levels of restricted cash. This provides us with a less capital-intensive way to develop gas and electricity retail sales business in Poland. Changes in working capital were also supportive of cash flows, on the back of decreased oil shale and shale oil inventories. Pellet and gas inventories slightly continued from their second quarter inventory increases to be ready for the main sales season in the coming months, but those items were small compared to oil shale and shale oil inventory changes. Interest paid in the third quarter is the highest throughout the year, as in September we pay annual interest on the 500 million 2023 Eurobond. In addition to that item there were some usual loan principal repayments together with interest that took the interest paid amount to 14.5 million euros.

On slide number 19, we have compared the third quarter operating cashflows of last year and this year. This year's third quarter operating cash flows were significantly stronger. The biggest changes came from working capital where accounts receivables and payables have seen positive trends together with decreased oil shale inventories in our Large-Scale Energy Production unit. Positive CO2 is explained by higher Income Statement related provisions as this year's third quarter electricity production from oil shale was higher from last year's levels, and there were no significant CO2 price movements. Cash flows related to derivative instruments were more positive in this year's third quarter. The positive effect came mainly from electricity instruments, while oil and gas related derivative instrument movements were slightly more negative.

Moving on to slide 20, let's look at Eesti Energia's investment related cash flow during the ended third quarter. The group's capex amounted to 35 million euros, increasing by 9.4% 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's quality by making the connections more weather-proof and building new connection points. On a yearly basis such investments rose by more than a third. One factor here is the increased number of applications from electricity producers related to the ongoing solar boom in Estonia, while base investments to the network have also increased. During the quarter we also completed the purchase of Tolpanvaara wind park project in Finland, an acquisition that was signed back in 2018.

Turning to slide number 21, we have provided an overview of the Group's liquidity position. At the end of September, Eesti Energia's cash position amounted to 129.1 million euros. During the quarter the used revolving credit facilities were paid back in

the amount of 30 million euros in addition to contractual principal payments that amounted to nearly 22 million euros. During the quarter we signed new revolving credit facilities in the amount of 320 million euros, from which 200 million euros will mature in 5 years and 120 million euros in 3 years. As of the end of the third quarter, the group had access to 590 million euros of loans. From this amount 245 million euros are long-term loan agreements with the European Investment Bank, revolving credit facilities at the parent company level in the amount of 320 million euros and at the Enefit Green level we have one revolving credit line in the amount of 25 million euros.

On slide 22, we have provided an overview of the group’s leverage ratios and debt repayment profile. During the quarter, both Standard and Poor’s and Moody’s updated their credit ratings for Eesti Energia. Standard and Poor’s left the rating unchanged to BBB-, but changed outlook from stable to negative due to weaker credit metrics. Moody’s left the rating and outlook unchanged, Baa3 with stable outlook, citing the high probability of support from the owner of the company, the Government of Estonia, if needed. Company's net debt to EBITDA ratio stood at 4.2x at the end of the quarter, declining from the first and second quarter figures. 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 metrics. Eesti Energia's financial policy is aimed at maintaining investment grade credit rating.

Turning to slide number 23, let’s cover the management outlook for the remainder of this year. The management outlook has not changed from the second 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 of 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 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. 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 as we move onwards. Currently it is expected that increase will come from investments into electricity network and into renewable developments, while at this time no major renewable development investment decisions have been made. Investments regarding oil shale sector are expected to decrease. The investments regarding the new shale oil plant Enefit-282 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 third quarter of 2020. During the third quarter we saw the trends from the first six months of the year continue, illustrated by low electricity and oil prices. Although oil prices have somewhat recovered, hedge transactions still continue to provide shelter for our shale oil operations. In the third quarter there were some additional oil sales that were postponed from the second quarter, thus having a one-off effect on the shale oil’s results. In the distribution segment we have seen recovering consumption volumes, but still the electricity consumption is below the levels we saw before the Covid-19 pandemic. However better operating efficiency in the distribution business has helped

to keep EBITDA stable, or even growing as witnessed in the latest quarter. The third quarter ended with a net loss of 8.0 million euros compared to last year's third quarter loss of 9.6 million euros. Overall, we can say is 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 situations 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 listening. We will introduce our annual results at the end of February. Thank you.