Eesti Energia Unaudited Financial Results for 2021

28 February 2022
Transcription

Introduction by Rasmus Noormägi

Ladies and gentlemen, thank you for standing by. My name is Rasmus Noormägi, Head of Investor Relations and Treasury of Eesti Energia. Welcome and thank you for joining Eesti Energia 2021 annual results & investor presentation conference call. Throughout today's recorded presentation, all participants will be in a listen only mode. Should you have any questions, you may write them in the chat, or after the presentation we are available for a question and answer session.
I would now like to turn the conference over to Andri Avila, Chief Financial Officer of Eesti Energia. Please go ahead.

Main content by Andri Avila

Dear investors and partners, my name is Andri Avila, Chief Financial Officer of Eesti Energia. I am glad to welcome you to our conference call discussing Eesti Energia's financial results of 2021. I hope you have had a chance to download the report and the investor presentation from our web site. We will be also showing the slides on the screen as we go along.

Slide 3

Let's start from slide number 3 with the overview of the results. We have added a new slide to provide an operational overview of 2021 which was historical in many aspects. First, 2021 was the 1st year retail electricity sold in home markets of Latvia, Lithuania, Poland and Finland, exceeded those of Estonia. Total sales of electricity amounted to 8.6TWH in 2021, a quarter more than in 2020, with sales in other home markets than Estonia accounting for 52%. Secondly, electricity generation rose by 37% to 5.2TWh as the importance of security of supply came well to the focus in Europe. In 2021, especially in the last quarter, our hybrid power plants saw a lot more usage than expected. For example, during high price hours in the fourth quarter electricity flowed from Estonia to Finland while usually electricity moves from Finland to Estonia. With peak hour prices well above two-three hundred euros per MWh, our production units were able to provide relief to the region suffering from a deficit of electricity production units. Renewable generation increase by 10% to 1.6TWH came from higher biomass usage at our hybrid power plants, which a couple of years ago ran on oil shale only. For 2021 renewable generation accounted for 31.5% compared to 39.8% in 2020. Renewable electricity generation from wind and solar production was 12% lower from 2020 levels as weather conditions were less favourable. As security of supply became the name of the game, our CO2 intensity and absolute emissions also rose compared to 2020. The decrease in shale oil production is attributable to larger maintenances carried out last year compared to 2020 while the DSO network saw record high distributed volumes with first time annual volumes above 7TWh as economic recovery from the COVID-19 pandemic continued.

Slide 4

Now turning to next slide, number 4, as a consequence of strong operations and high electricity price environment, we saw near 50% increases in sales revenues and EBITDA, respectively to above 1.3 billion and 318 million euros. Operating cash flow was weaker in 2021 due to double purchases of CO2 allowances during the year, as in 2020 we postponed the CO2 purchase to 2021. Given the good liquidity of the Group, the 2021 European Emission Allowances, which are to be surrendered by this year's April, were purchased in December 2021. CO2 net purchases when adjusted to received mark-to-markets amounted to 291 million euros in 2021, while gross purchase amount was ca 120 million euros higher. Investments increased by roughly a third led by DSO, renewable and chemical industry transition capex. We will cover the financials in more detail later. Now let's do the traditional overview of our main commodity markets.

Slide 5

Moving to slide number 5 and the electricity market. 2021 witnessed rising price dynamics throughout the year as consumption recovered and natural gas prices were at their historic highs which has significantly increased the variable cost of gas-fired power plants. The 2021 fourth quarter record-high electricity prices were the result of many factors from the supply and demand side – all-time high gas prices, shortage of low-cost electricity generation capacities, including lower than historical average Nordic hydro levels, maintenance schedules of controllable power units, and colder than usual December weather in the region which resulted in larger than expected demand for electricity. As a result of fourth quarter rising electricity prices, the yearly average electricity price in Estonia was ca 2.5 times higher than in 2020. Although price spread between Estonia and Finland widened in the fourth quarter, suggesting insufficient interconnection capacities, there were some peak hours were Finland imported electricity from Estonia to cover peak demand. Price spread in the fourth quarter between Estonia and Latvia widened to its highest in the last couple of years as our hybrid power plants provided electricity to the region while interconnection capacities were not sufficient to eliminate the price differences. Still, the Estonia-Latvian price spread was minor compared to that of Estonia-Finland. Clean dark spread and average electricity price achieved by Group's hybrid power plants increased significantly as regional electricity market prices were at their record highs, and power plant operation was aimed to production during peak hours despite negative effect from tripling CO_2 prices.

Slide 6

On slide 6 we have concluded the movements of the oil markets which saw similar trends to electricity amidst economic recovery which increased demand while the supply side has proven slow in its response. The market price movements of brent and 1% sulphur content fuel oil have been expectedly similar.

Slide 7

Now let's move onto the financial overview of Group's results, so kindly turn to slide number 7. Both sales and EBITDA of the Group increased with electricity segment being the main driver on the back of high electricity market price environment. DSO segment's performance was pretty much stable despite record distributed volumes, and therefore higher revenues, which were strained by high electricity purchase costs for network losses due to record high electricity prices. Shale oil segment's growth was held back by lower production quantities and hedges made from lower price levels.
Hedge transactions carried out according to internal risk mandates mostly fall under the IFRS hedge accounting framework, thus not affecting the Income Statement with the market price movements of unsettled instruments before the final settlement. However, there are some hedges related to gas, oil, electricity that do not fall under the IFRS hedge accounting framework thus affecting the Income Statement over the lifetime of the instruments with the market price changes. We will bring those situations

out in the coming slides separately as the effects have been in both directions and quite significant.

Slide 9

To cover the electricity segment, please turn to slide number 9. Sales revenues of the electricity segment rose by more than 2 times from 360 to 766 million euros due to larger quantities and higher prices. Average electricity sales prices increased but to a lower extent compared to NordPool market prices due to fixed price contracts of the retail portfolio, while as shown on slide number 5 the prices achieved by controllable power plants achieved higher prices compared to market's average throughout the year. Electricity sales volume increase comes from retail portfolio, where all home markets saw higher volumes led by Poland, Lithuania and Latvia all with 25% or larger increases in their portfolio. Wholesale volumes account for the minor part of volumes and therefore the decrease of the wholesale volumes did not have too significant effect. As pointed out earlier in the presentation, generation increased significantly from 2020, also helping the economics of the electricity segment. The group makes hedge transactions to lower the risk of the volatile market price environment for retail and power production portfolios separately. A more detailed view of the hedged positions can be seen on slide number 26 in the appendices.

Slide 10

Moving to the next slide, electricity EBITDA development is portrayed. The only red column on the graph relates to fixed costs as the internal cost division for resources is based on oil shale usage. As a result of higher electricity production from 2020 levels, electricity segment received a bigger share of fixed costs, which then again was offset by larger revenues from better prices and larger quantities both on the retail and production side of the electricity segment. These effects are gathered under the columns of "Margin Impact" and "Volume Impact".
Two of the biggest green columns on the slide relate to hedge transactions. The smaller column, "Gain on derivatives", includes the settled instruments with a positive annual effect of +54 million euros. The higher column mostly includes mostly the change in the value of Power Purchase Agreements and this is the part not covered under the IFRS hedge accounting framework. This 60.5 million euro column mostly comprises of Power Purchase Agreements priced according to latest electricity market price forecasts. During last year we signed fixed price renewable electricity agreements with Baltic consumers in the amount of approximately 9TWH for the next 10 years to cover the electricity production of the Group's newly decided investment decisions, and also the electricity to be produced by other renewable developers in the region. As the market price forecasts have increased, so has the market value of those contracts.
In the absence of other instruments, the PPAs have been the main reason for renewable related investment decision made during 2021 for 200MW of new added capacity.

Slide 12

Carrying on form slide number 12, let's go over the distribution segment which saw record volumes in 2021. Without the effect of the acquisition of a smaller DSO that was completed in mid-2021, distributed volumes would have been still above 7TWh, an all-time record. The main factor in DSO's higher sales revenues were the larger volumes as overall economic activity has picked up, while average sales price was just 0.1 euros per MWh higher. Although network losses slightly increased, the duration of interruptions compared to 2020 decreased showing better operational network quality.

Slide 13

On slide number 13, the overview of distribution EBITDA has been provided. The largest impact to the DSO's profit came from network losses due to high electricity market prices as according to current regulation the network loss related costs cannot be hedged, thus depending on market prices. The larger volumes and lower fixed costs were not sufficient to make up the lost ground of increased electricity purchase costs. The other column of 1.9 million euros relates to the acquisition as the assets were acquired below book value.

Slide 15

Next, let's move on to shale oil operations. 2.2% decrease in shale oil sales revenues can be traced down to lower sales volumes which were the result of lower production despite significantly higher market prices. Lower production was the result of larger repair and reconstruction works in 2021 compared to 2020. Hedges made from previous periods impacted the final sales price negatively compared to market prices, but on annual comparison average sales price including hedges increased by 5.6% to 321.6 euros per tonne.

Slide 16

As to shale oil EBITDA, significant impacts came from hedge transactions. The "gain on derivatives" column shows the impact on hedges for the period's settled hedges only, while the "Other" column includes the already mentioned hedges not covered under IFRS hedge accounting framework. For shale oil segment this involves Naphtha derivatives used to hedge the gasoline fraction of the production which accounts for around 10% of the liquid fuel production. As oil world market prices have increased compared to our hedge levels and last year's level, there is a negative effect to the PNL already before the actual settlement takes place. However, from the beginning of this year, the Naphtha hedges are included under hedge accounting and therefore going forward there will be no more such impacts, but the comparison effect remains throughout this year. We have also provided an illustration of comparable EBITDA profit which ignores the yet-to-be settled hedge impacts.

Slide 17

To cover other products and services, please turn to slide number 17. Highest impacts to sales revenues came for higher gas sales which increased roughly two times from 2020, but also sales of pellets and heat rose. As for gas sales revenues, most of the increase was market price driven, while gas sales quantity increased by 15% from approximately 2TWh to 2.4TWH. EBITDA of other products and services declined mostly due to mark-to-market impacts of unrealised gas financial hedges which amounted to approximately 14 million euros, while 4.7 million euros were attributable to the settled part. As to gas hedges, the mark-to-market impacts relate only to financial hedges while the group also owns approximately 0.5TWH of physical gas storage accumulated before the second half of 2021 with an average price of 25 euros per MWh. This gas storage is not evaluated to market price, and therefor will affect the 2022 gas result positively if the current high gas price environment remains.

Other changes in EBITDA which were at 5.1 million euros included several factors. Realisation of the Auvere compensation in the amount of 28 million euros was the main positive factor, while the absence of proceeds from surplus CO_2 allowance sales in 2021 which took place in 2020 in the amount 14 million euros has a negative comparative effect. Also in Q4 2021 there was a court settlement which resulted in 7 million euro settlement payable by the Group to the plaintiff.

Slide 18

On next slide we have provided a comparison of 2021 EBITDA and Operating cash flows. Operating cash flows were 121.8 million euros weaker mainly due to working capital changes, interest payments and other factors which mainly relate to the amortisation of DSO's connection fees and recognition of investments that under IFRS are treated according to the equity method due to Group's ownership in such projects. Those investments were mainly tied to the contractual liabilities of the Jordan project. Working capital column portrays the impact from high electricity prices as client receivables as of year-end increased significantly. CO_2 and derivative instrument impacts netted each other pretty much out despite having double purchase of CO_2 emission allowances during the year in the net amount of 291 million euros, in gross ca 120 million euros higher. In 2020 we postponed the CO_2 purchases to April 2021 and at the end of last year we bought out quotas that are to be surrendered for 2021 by this year's April. The group did not pay any dividends in 2021 to its owner, however the income tax column is tied to tax accounting in Group's Lithuanian subsidiaries.

Slide 19

Moving onwards to the next slide we have compared operating cash flows from 2021 to 2020. The main factors are the same as on the last slide. Working capital column portrays the difference from high electricity and gas prices as client receivables at the end of year were higher due to larger deliveries in monetary terms. So far in 2022 we have seen client receivables development in its normal course with no major spikes, although in nominal terms the debt amounts have been somewhat elevated. When adjusting debt amounts to the larger deliveries, the adjusted debt figures are actually lower compared to year ago periods. Moving on with the CO_2 column which is negative due to same reasons as touched upon earlier, the double purchases of CO_2 quotas in the net amount of 291 million euros during 2021. Biggest positive impact to cash flows came from stronger EBITDA figure with derivative impacts from oil, gas, and electricity hedges were also positive. In 2021 we implemented collateral financing service for initial margin collaterals offered by SEB which helped to free up working capital from collaterals in the amount of around 50 million euros. Lower interest in 2021 was the result of a bond maturity in November 2020 that had a coupon rate above 4%.

Slide 20

To cover the capex overview, let's turn to slide 20. Capex increased by more than a third in annual comparison amounting to 252 million euros in 2021. Electricity network investments aimed at strengthening the distribution network still account for the largest share of investments. The biggest increase to investments came from other development investments which in large extent are investments to the new chemical plant Enefit-280 which serves as a cornerstone for transforming the current liquid fuels and electricity oriented production from oil shale to chemical industry based on circular economy principles with a zero carbon footprint target by 2045. Although renewable energy investments decreased in annual comparison, 2021 saw investments to several new wind parks related to the actual construction activities, while 2020 investments were mostly acquisition related. With the ending year the Group made investment

decisions on nearly 200MW of new wind parks to be built which increases renewable investments in the next couple of years significantly. The group's aim is to increase wind and solar installed capacity from current levels ca 2.5 times to 1100MW by 2025. Although from the outset, one would think that the high electricity price environment encourages renewable investments, then from our point of view things look slightly different. The volatility of the electricity prices serves as a heavy headwind when it comes to prudency in making final investment decisions. To ensure an encouraging investment climate we see PPAs, Power Purchase Agreements, and state offered support schemes as solutions for ramping out investment decisions on low variable cost renewable production units. We also monitor the development of different storage capabilities with great interest, but for the time being industrial-scale storage do not have the economics to justify the associated cost.
The investment decisions on nearly 200MW of new wind parks in last year were mostly covered with fixed price renewable electricity sales agreements, the PPAs, with our Baltic consumers.

Slide 21

Turning to slide number 21 an overview of the Group's liquidity position is provided. At the end of 2021, Group's cash position amounted to 198 million euros. During 2021 we successfully concluded Enefit Green's IPO in the amount of 175 million euros, thus the positive financing cash flow which otherwise would have been negative due to loan repayments. During 2021 the Group signed several new loan agreements or amendments to existing facilities, an overview of those has been provided in the report in more detail. Total undisbursed loans amounted to 535 million euros as of the 2021-year end. In January 2022 Enefit Green signed a new loan agreement with NIB, Nordic Investmen Bank, bringing total undisbursed loans to 615 million euros.

Slide 22

On slide 22, there is an overview of the group's leverage ratios and debt repayment profile. On the back of strong operating cash flows and EBITDA, and successful IPO of the minority listing in October last year, the net debt to EBITDA ratio of the Group has declined to 2.4. The group's credit ratings remain unchanged, BBB- from Standard and Poor's and Baa3 from Moody's. Eesti Energia's financial policy is aimed at maintaining investment grade credit rating and a net-debt to EBITDA long-term target of 3.5 times. For the upcoming quarters we expect the net-debt/EBITDA ratio to increase as the Group continues the execution of its investment pipeline.

Slide 23

Turning to the 2022 Outlook on slide 23, the management of the Group expects growth in sales revenues and investments while EBITDA is expected to decline. Growth in Group's sales revenue is expected mostly from higher electricity market price and volumes. Expected EBITDA decline is traceable to rising market prices which will affect costs negatively, while also keeping in mind that the 2021 figure included some one-off items. Investments are expected to grow from the levels of 2021, with increase expected from renewable energy developments and the construction of the chemical plant.

Slide 24

To conclude today's presentation, please turn to the last slide, number 24. Group's performance in 2021 resulted in a record turnover of above 1.3 billion euros, on the back of high electricity price environment witnessed in the second half of the year. Segments showed mixed performance due to different reasons, but overall, we feel that the group managed to use the market conditions in its favour resulting in a net profit of 111 million euros, highest since 2016. The management proposes to the owner a dividend payment of 50% of the net profit, 55.7 million euros. The owner is expected to decide the dividend payment together with the approval of the 2021 audited report in April.

Question and answer session

Ladies and gentlemen, at this time, we will begin the question and answer session.
Anyone who wishes to ask a question, please use the “raise hand” feature or write a question to the chat.

Question

So indeed, we have a question, so the question is in the chat and I will read the question out: “Does Eesti Energia have any plans for its €500 million Eurobond maturing in September 2023? Does it plan to refinance with another bond, or pay it down with existing cash and credit facilities? Might any new bonds include a Green or an ESG component?”

Answer by Andri Avila

Thank you for the question. Indeed, we have a €500 million Eurobond maturing in September next year and we have plans regarding financing it. One thing we keep in mind of course is the requirement, or expectation, from our rating agencies to have financing in place at least 12 months before maturing of obligations. This is what we keep in mind, other than that we cannot really reveal any specific plans regarding the type of the bond or exact timeline. But this refinancing is going to happen in due course, we are aiming to do it before the mentioned 12 month period.

Closing comments

Okay, so any other questions from anyone? We will wait for half a minute. But seems that there are no further questions at this moment. So I will hand back to Andri Avila for closing comments.

Closing comments by Andri Avila

Thank you for listening and let’s see you again at the beginning of May when we present our 2022 first quarter results. Thank you