Eesti Energia Unaudited Financial Results for Q2 2021

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Transcription

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Dear investors and partners, my name is Rasmus Noormägi , Head of Treasury and Investor relations of Eesti Energia. I am glad to welcome you to our conference call discussing Eesti Energia's financial results of this year's second quarter. I hope you have downloaded the quarterly report and the investor presentation from our web site.

To start off with the overview of the results, let's start from slide number 3. Overall, the start to the year has been strong with second quarter sales revenue growth continuing the trends we saw in the first quarter of this year. Group's second quarter sales revenues increased by 43.5% from last year's same period, led by the electricity segment. EBITDA however fell by nearly a quarter from last year's figures mostly due to financial derivative transaction effects from the oil segment, and to a smaller extent from gas hedges. Those hedge effects come from daily market price changes of the hedges made at fixed prices and are not covered with the IFRS hedge accounting framework thus having a non-monetary Profit and Loss effect. Such effect in the second quarter of this year was in total -10 million euros, with 7 million euros from oil instruments and nearly 3 million from gas instruments. Still, most of our hedge transactions for electricity and oil instruments are covered with the mentioned IFRS hedge accounting framework. This results in the daily market price movements of the hedges not having an effect on the EBITDA figure on a daily basis, but only when the final settlements of the instruments occur. We will cover this topic a bit detail later on. All in all, the management of the group is satisfied with the group's organic results despite the drop in EBITDA figures as a result of hedging impacts. Operating cash flow in the second quarter fell to a minus figure due to CO2 allowance buy out in the amount of 99 million euros in this year's April, so with adjustment to this event the operating cash flows were at a similar level. Investments of the group increased by nearly 2 times compared to last year's second quarter, as the first payments related to the construction of the new oil plant have started, but also the distribution network has seen more capex compared to last year's same period.

Before we move on to the review of the financial results, we will provide a brief overview of our main commodity markets. So please turn to slide number 4 to cover electricity markets. Second quarter of 2021 saw increasing electricity prices in the Baltic and Nordic regions continuing the trend from the first quarter of the year. Compared to last year's second quarter, prices in the region are nearly 2 times higher this year. Also, second quarter of 2021 goes down to history books with the all-time high quarterly average electricity price for the Estonian price region. Current Outlook is such that the third quarter average electricity prices look to set a new all-time record once again. Currently high electricity prices are the result of maintenances of region's controllable power units, limited capacities of interconnecting cables, and low renewable energy supply due to low winds, and below historical median hydro reservoir levels in the Nordics. With regards to price spreads, we have witnessed the widening of the electricity prices between different Nord Pool regions as a result of the before-mentioned reasons. The quarterly average clean dark spread metric is still in the negative territory for the quarter as far as the average is concerned. However, the metric is based on market prices of electricity and CO2 prices showing the available margin of Eesti Energia's oil shale based power plants while in reality the power units are run against the current moment's actual market prices. This means that the production is aimed at peaks hours, the result of which is the red line on the graph, that is the average electricity price achieved by Enefit Power's production units. In addition, the actual CO2 cost is lower than market price due to hedges from the past from lower price levels and free allowances. Last but not least, this year we have managed to add biomass on a constant basis which in turn has lowered the share of oil shale needed to produce electricity.

Next, let's turn to slide number 5 to briefly cover the oil markets. As with regional electricity prices, global oil prices have also recovered quarter by quarter since the beginning of last year achieving basically pre-decline levels seen back in 2019. On a yearly comparison basis, brent and fuel oil prices were both roughly 2 times higher moving together quite similarly. During the quarter oil prices got support from production restriction agreement by OPEC countries, similar to first quarter events on the oil market.

Moving on to the overview of financial results, please turn to slide number 6. Higher sales revenue is mostly the result of electricity segment's strong performance, while all other segments also contributed. The picture of the EBITDA bridge is however more mixed – electricity and distribution business managed to show improving EBITDA, while shale oil segment saw effects from hedge transaction impacts pull the segment's EBITDA result to minus territory. The other products and services segment's EBITDA result was last year effected from positive CO2 sales impact in the amount of ca 14 million euros – this event is the main reason of the lower profit, but there were some gas related hedging affects as well. But as mentioned before, the management of the group is satisfied with the group's organic results despite the drop in EBITDA figures.

To cover the electricity segment in more detail, please turn to slide number 8. The dynamics of the sales side of the electricity segment continued first quarter trends. Higher quarterly electricity prices with increased sales volume thanks to better retail sales quantities led to higher electricity sales revenue. Increase in the average electricity sales price for the Group was lower than the increase in the market price as a significant part of retail contracts have fixed prices. Such fixed price contracts are fully hedged, so the higher market price does not have any effect here. Regarding sales volumes, most of the rise came from the Lithuanian and Polish markets which combined increased by 300GWh of the total 400. Market shares in our home markets have been consistent or developing – in Estonia we have around 57% market share, in Latvia and Lithuania around 15-16%, while in Poland our operations are still developing with market share below 1%.

Electricity generation in the second quarter rose by a nearly half from last year's same period to 0.9 TWh as electricity prices were favorable and allowed the oil shale based power units to access the market more than a year ago in the second quarter. Renewable electricity production increased by 36% to 0.4TWh despite less favorable wind conditions in annual comparison. The support to renewable electricity production came from record biomass usage at our traditionally oil shale fired power plants. The improvements of our engineers to the power units enable to use more alternative fuels, such as retort gas from oil production, instead of oil shale. This makes the oil shale based power units more competitive and allow for more flexibility while operating the plants on the back of rising CO2 prices, as the CO2 intensive oil shale share is reduced in the fuel mix. Our goal is to improve the traditionally oil-shale based power units as much as possible to an extent where the share of oil shale is as low as possible, in some units this means as low as 10%. Also, the biomass we use is basically waste wood from construction sites or forestry with very few alternative uses, therefore the price of such biomass is not comparable to that of pellets for example. The share of electricity produced from renewable and alternative sources from Group's total electricity production was at 57% for the quarter, for renewable only at 42%. As to the hedging, we hedge our power production units and retail sales separately, with more details on the hedges available in the appendices.

Moving to next side, the EBITDA profit of the electricity segment grew 79% from last year's levels with positive factors outweighing negative ones. The graph on the slide is pretty similar to that of the first quarter – compared to last year's same period EBITDA figure positive contributions came from higher sales volumes, derivative transactions, power purchase agreements, but also from lower fixed costs. The key change from last year's second quarter

is the addition of PPAs, Power Purchase Agreements. From last year's August we have signed two long-term Power Purchase Agreements with wind developers in Lithuania. This electricity is then offered and sold to retail clients in the Baltics who wish to consume renewable energy. As the electricity market price forecasts change, the value of those signed PPA contracts also change for the unhedged part and this is portrayed under the „Other" column together with the unrealized impact from derivative transactions. Hedging for the PPA contracts is done by the internal Client Services unit who offers long term renewable energy solutions to consumers in the Baltics and in Poland. The product has been especially well received by the clients from the beginning of this year. Negative impacts to EBITDA compared to last year came mainly from margin impact. Although the margin impact column was positively effected by the higher electricity sales prices, the larger negative effect comes from higher variable costs which mainly relate to higher electricity purchase costs due to higher market prices.

Next, let's cover the distribution segment's performance on slide 11. Distribution sales revenues increased by 5% to 52.4 million euros while benefitting from higher distributed volumes despite the fall in the average sales price. Last year the average sales price, the tariff, saw the same amount of increase as the consumption profile shifted towards household clients as a result of the COVID-19 pandemic. This year's second quarter average tariff was at the pre-pandemic level as more and more people have moved back to offices, and at least seems that we are closer to normal life than a year ago. The rise in the planned interruptions depends on the maintenance schedule, while the unplanned interruptions mostly depend on weather conditions which in this year's second quarter were more adverse. A significant change in the distribution network compared to last year, is the addition of solar power plants connected to the distribution network. First time in the history, the threshold of 200MW for PV production in the distribution network was crossed. The record production hour took place in the afternoon of April 18th this year with the PV production making up 30% of the network's consumption.

On the next slide, number 12, we have provided the EBITDA development of the distribution segment. As with the electricity segment, the graph on the slide is very similar to that of the first quarter of this year. Higher distributed volumes had the largest impact here together with lower fixed costs from lower maintenance costs. Maintenance costs are lower, however as shown in later slides total investments to the distribution grid have risen significantly. Margin impact's negative effect is attributable to costs related to network losses as electricity prices have been higher, but also the decrease of the tariff plays a role here. All in all, the EBITDA of the distribution business increased by 11% from last year's second quarter figure to 27.2 million euros.

Now, let's continue with the shale oil segment on slide number 14. As was the story in the first quarter, despite oil prices globally rising, our hedge transactions made at lower prices levels have had a restraining impact on the sales revenue growth when compared to world oil price increases and taking into account 21% higher sales volumes. Last year's sales volumes were a quarter lower than usual as we took advantage of our flexible delivery agreements, with this year's second quarter sales volumes returning to the normal level. Similarly, last year in the second quarter we brought planned maintenances earlier, thus effecting the year ago production volumes. All things considered, we are satisfied with the oil production operations and look forward to setting a new record for annual oil production. To briefly comment on the hedges, for 2021 we have hedged around 80% of our forecasted volumes, and for 2022 nearly 70%.

Now please turn to next slide number 15 to cover shale oil EBITDA. While other segments had similar EBITDA development trends in the second quarter as in the first, the shale oil EBITDA bridge looks quite different. Major negative effects compared to last year's outcome came from derivative instruments, or the hedges. The effects of the hedges for this year's second quarter

and previous year were in opposite directions resulting in net difference of nearly 13 million euros between the two periods. The reason is that during last year's second quarter our hedges that were settled were made at prices above the then current market prices, while exactly the opposite is true for this year and therefore the big difference. Basically same reasoning goes for the „Other" column, where the hedges for the gasoline fraction of our production have resulted in a net effect of nearly minus 10 million euros compared to last year's second quarter, from which 7 million relates to market-to-market movements of existing positions and 2.5 million euros is the share of the settled positions during the quarter. Since the gasoline fraction of our production is also hedged, but not covered under the IFRS hedge accounting framework, then the price difference between the hedged positions and current market price runs through the PNL statement. For clarity, the column „Gain on derivatives" only includes the result of settled positions, the realised gain, for fuel oil fraction of our production which is the main product. Inclusion of only settled positions means that the market-to-market impact, the unrealised gain, is covered with the IFRS hedge accounting framework, thus having no effect on the PNL statement.

Other than that the shale oil operations showed good performance. When adjusting for the market-to-market movements running through the PNL mentioned before, the EBITDA profit for the quarter was at a similar level as a year ago.

Next, let's cover the last segment, other products and services, on slide number 16. Sales revenue of „Other products and services" increased on an annual comparison basis, with improvements mostly coming from sales of natural gas and pellets. EBITDA profit of the segment declined on an annual comparison as last year's number included 14 million euro impact from sale of excess CO2 emission allowances. Another negative impact came from gas where we saw lowering effect from the before mentioned hedges as for gas transactions there is also currently no IFRS hedge accounting framework in place, which means that the Profit and Loss statement is influenced by the hedged positions daily price changes, not only by the final settlements.

Next, we shall provide a brief overview of cash flow development on the next slides. To start from slide number 17, we have provided a bridge from EBITDA to operating cash flow for the second quarter of this year. The operating cash flow was 46 million euros lower than the EBITDA mainly due to CO2 impact as the CO2 emission allowance buyout for the allowances surrendered for the year of 2020 took place in April before the actual surrender of the quotas in the amount of 99 million euros. This means that other CO2 related effects had positive impact in the amount of ca 50 million euros. These other effects are the collateral movements associated to CO2 instruments and PNL related provisions. For further background, in the Profit and Loss Statement the CO2 expense item occurs but there is no cash outflow tied to the CO2 expense because the actual CO2 allowances are bought out usually once a year, as in this year's April, while hedges we make on a continuous basis. The column „Derivative instruments" relates to the similar market-to-market price movement logic as described in previous slides, but here the cash impact comes mainly from electricity instruments which fall under IFRS hedge accounting framework, thus having an effect on cash flows, but not in the Income Statements. While the opposite is true for most of the oil hedge transactions that had an impact on the shale oil EBITDA – there are no cash outflows because the trades are done on the OTC market, but the market-to-market impact occurs because there is no IFRS hedge accounting framework in place. Other movements were more modest, with working capital changes showing its seasonal negative trend mainly led by inventory increases for gas to prepare for the next delivery season.

On slide number 18, we have provided a bridge from the 2020 second quarter to this year's second quarter operating cash flow. As in the previous slide, CO2 is the main culprit here with

the 99 million euro buyout transaction with lower EBITDA being the second suspect. Derivative instrument movements as a whole for the quarter were quite similar to last year's effects, but electricity and oil related instruments saw developments in opposite directions. Compared to last year's second quarter, difference from electricity related instruments amounted to -15 million euros and the same figure from oil related instruments amounted to +13 million euros. Other than that, the operating cash flows were pretty similar during the two quarters.

Moving on to slide number 19, we have provided an overview of the investments made during the quarter. Capex related activities have really picked up, with the distribution grid related investments rising, but also other development Projects seeing more activities. The largest here is the construction of the new oil plant, with which we have carried along. During the quarter, the construction permit was temporarily halted by the local Estonian courts with temporary legal protection as a non-profit organisation of climate activists demanded for the annulment of the construction permit. So far, two instances of court have decided that the construction permit is in full force. However, the court case is still pending as the plaintiffs have turned to the Supreme Court. The Group's management feels that the plaintiffs arguments are well covered with the oil plant's environmental impact assessment which the plaintiffs argue is incomplete. Additionally, to comment on the new oil plant, although there have been news in the local media regarding the rationale of the new oil plant, the management of the Group sees the new oil plant together with investments to traditional renewable capacities such as wind, solar, as the cornerstone to position the Group the best way possible for the future taking into account today's mega trends, and the expectations from its owner, the State of Estonia. As part of the group's long term strategy, in early June we announced our 2045 decarbonisation strategy. At the core of this strategy is the new oil plant together with additional renewable capacities which in future can help to turn the today's main product of the oil plants from oil to chemicals used in every step in our everyday lives, and using in turn old plastics instead of oil shale as the main fuel to produce different chemical products. On group level our target is to be carbon neutral by 2045, with the 2030 EU goals already achieved. More information on the decarbonisation strategy can be found on our homepage under the „Responsible energy" section.

In the second quarter of this year we also announced the final investment decision of a 43MW wind park in Lithuania, for which also a first down payment for the wind turbines was made in the amount of 4 million euros. This is an inhouse development project with which we have managed to get to long-waited the realisation phase.

Turning to next slide, number 20, an overview of the Group's liquidity position is provided. At the end of the second quarter, Group's cash position amounted to 142.4 million euros. In addition the group has access to 580 million euros of undisbursed loans, which are divided between revolving credit facilities and long-term loan agreements from the European Investment Bank. During the quarter the group returned part of utilised Credit facility in the amount of 40 million euros, and made a contractual debt repayments of ca 10 million euros.

On slide 21, we have provided an overview of the group's leverage ratios and debt repayment profile. The group's credit ratings remain unchanged, BBB- from Standard and Poor's and Baa3 from Moody's with Eesti Energia's financial policy aimed at maintaining investment grade credit rating and a net-debt to EBITDA long-term target of 3.5 times.

Turning to the 2021 Outlook on slide 22, the Outlook has not changed from the end of first quarter. Growth in sales revenues, EBITDA and investments are expected by the management of the group. Growth in Group's sales revenue and EBITDA is expected mostly from higher electricity market price and higher electricity sales volumes. Investments are expected to grow from the levels of 2020, with increase expected from renewable energy developments and the

construction of the new shale oil production unit. It is the management's opinion that the Covid-19 pandemic is still not yet over despite the vaccine roll-outs. Therefore active monitoring of the circumstances is continuing on a daily basis with the readiness for necessary adjustments if needed.

To conclude today's presentation, please turn to the last slide, number 23. On the back of climbing market prices of electricity and oil, the Group's performance continues the recovery from the low levels of last year. Electricity segment has shown most improvement with distribution business also showing nice performing. Although shale oil profit has decreased due to financial transaction impacts not covered by IFRS hedge accounting framework, the operations of oil production are going smoothly with production levels increasing from the levels of last year. Although the second quarter ended with a net loss of 10 million euros, the company's management is satisfied with the overall performance of the Group. Last but not least, as mentioned in our first quarter investor call in the beginning of May, the annual general meeting has decided not to take a dividend payment this year providing additional support to the company to accomplish its strategic goals and carry out the related investment plan. That is all for the second quarter of this year, we are now ready to take your questions.

Lõppsõna

Thank you for listening and hope to see you again at the end of October when we present our third quarter results.

Thank you and enjoy the day.