# Eesti Energia Unaudited Financial Results for Q3 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 third quarter. I hope you have downloaded the quarterly report and the investor presentation from our web site.

Let's start from slide number 3 with the overview of the results. On the back of historically high regional electricity prices Eesti Energia's sales revenue for the third quarter increased by 52% from last year's levels to 290.8 million euros. Quarterly EBITDA profit at the same time also increased by nearly a half, from 44.4 million euros to 65.9 million euros, however the performance of our segments was mixed. Operating cash flow of the group was strong, while investments grew to 60 million euros, up by 57% from last year's levels. We will cover the financials in more detail later, next let's do the traditional overview of our main commodity markets.

So please turn to slide number 4. After the record high electricity prices in the second quarter of this year, third quarter carried on with even higher price levels. Baltic and Nordic electricity prices rose by at least two and a half times on annual basis, while some price regions saw even higher increases. Higher electricity prices are the result of many different factors from the demand and supply sides. We would bring out the main ones as increased electricity demand by consumers, low Nordic hydro reservoir levels and high gas prices which have lifted the break-even prices significantly for gas-fired power plants. Price spread between Estonia-Finland has increased significantly, to nearly 19 euros per MWh on average for the quarter as existing connections between the two countries were not sufficient for an equal price environment. Price spread between Estonia-Latvia also widened on a quarterly and annual basis, although the price differences are on usual levels. The quarterly average clean dark spread metric which shows the available margin to oil shale power plants is back in the positive territory after ca two and a half years due to high electricity prices. Although CO2 prices are at record high levels as well and affect the metric negatively, the bigger rise in the electricity price is the reason the metric has returned to positive value.

Next, on slide number 5 let's briefly cover the oil markets. As with power prices, global oil prices have gone higher, but moves have been more modest compared to the moves power prices. On a yearly basis, brent and fuel oil prices were both roughly 70% higher in the third quarter moving together quite similarly as the global economic recovery has been somewhat quicker than anticipated, and the supply side of the market has not been so fast to adjust to the stronger demand. Given the news around possible challenges related to the Covid pandemic and ongoing economic recovery, a volatile ride can be expected for the coming quarters.

Now, let's turn to slide number 6 as we move on to the financial results of the group. Higher sales revenue is mostly the result of electricity segment's strong performance due to high electricity prices and larger volumes on the production and retail side. Shale oil operations were the only ones to see declining revenues There are specific reasons on the decreases of the shale oil segment, we will cover those in the upcoming slides. Rise in the EBITDA profit of the group was driven by the electricity segment's performance, while the "Other" segment is largely affected by gas related hedging affects which do not fall under hedge-accounting policy.

Turning to slide number 8, we have provided the traditional overview of the electricity sales revenues and volumes. Compared to last year's third quarter, both sales volumes and average sales prices increased resulting in higher electricity sales revenues. Retail sales volumes rose by 26% with all markets showing higher volumes from year ago levels due to increased overall consumption and larger market shares in Estonia, Latvia, Lithuania. Electricity generation rose by 12.4% to 1.2TWh for the quarter thanks to favourable electricity market prices that allowed the oil shale powered generation units to access the market more than a year ago. Electricity generation from renewable resources increased by 9% year-over-year as wind conditions in the third quarter were more favourable this year, and biomass usage at traditionally oil shale fired Narva power plants increased. Our goal is to improve the traditionally oil-shale based power units as much as possible so that the share of oil shale is minimal, in some units this means as low as 10% by the end of this year. Also, the biomass we use is waste wood from construction sites or forestry with very few alternative uses which offers a pricing advantage compared to the usage of pellets. The share of electricity produced from renewable and alternative sources from Group's total electricity production was at 43% for the quarter, for renewable only at 29%. 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 slide, the EBITDA profit of the electricity segment grew by nearly 53 million euros on an annual basis. The biggest effect to the profit came from the other column and this relates to the change in the value of derivative instruments mostly related to the power purchase agreements, or the so-called PPAs. From last year's August we have signed several long-term PPAs with regional wind developers. This electricity is then sold to retail clients who wish to consume renewable electricity, therefore hedging of the signed PPAs is done against the client portfolio. As the electricity market price forecasts change, the value of the signed PPA contracts change for the unhedged part and this is portrayed under the „Other" column together with the unrealized impact from derivative transactions. The only negative factor to the EBITDA bridge came from margin impact due to lower variable profit as a result of increased electricity purchasing and CO2 emission costs. However, as retail sales and production volumes were higher, margin impact was outweighed by larger volumes under the column of volume impact.

Now, please turn to slide 11 to cover the distribution segment. Distribution sales revenues increased by nearly 8% to 52.2 million euros mostly due to larger distributed volume. In the end of July this year we closed the acquisition of the third largest DSO network in Estonia, a deal that was announced in March this year. The acquired DSO has annual volume of around 0.2 TWh while group's DSO business distributes ca 6.5 to 7 TWh of electricity in a year. So there is slight effect in the increased volumes and revenues from the acquisition.

Next let's turn to slide 12 where the distribution segment's EBITDA profit development can be seen. The major reason for the EBITDA decline is the cost of the network losses. Although network losses decreased on annual comparison, electricity market price is another important factor in the equation. Since electricity market price has increased, the profit effect from network losses is negative dragging the EBITDA lower despite higher average sales price and volumes.

Please turn to slide number 14, to continue with the shale oil segment. Lower shale oil revenues in the third quarter were the direct result of different maintenance schedules from last year as lower production quantities directly impacted sales volumes. This year the main maintenances took place in the third quarter while in 2020 it was the second quarter. Still, for the full year we expect the annual total production and sales volumes on the same level as in 2020. As was the story in the first two quarters of this year, despite oil prices globally rising, our hedge transactions made at lower prices levels have had a restraining impact on the profit. The average sales price including derivative impact is around 311 euros per tonne which is nearly 4% higher than last year. In the appendices we have disclosed our shale oil hedges in more depth, separating fuel oil and naphtha hedges as in the accounting naphtha and fuel oil hedges are treated differently. Fuel oil hedges fall under IFRS hedge accounting framework, thus affecting the period's financials only with the settlement quantities of the ended period. Naphtha hedges, on the other hand, do not fall under IFRS hedge accounting framework yet and therefore affect the financials with the ended period's settled positions and as well with all future positions.

As we move on to slide number 15 impacts from naphtha derivatives together with lower sales volumes due to maintenances are the main reasons for shale oil segment's EBITDA loss. Although the biggest red column on the graph is the settled portion of the hedges, the „Gain on derivatives", then this columns is in the expected territory as the oil market prices have rallied while the group's hedges for this year are made from lower price levels according to group's hedging policy. When adjusting the EBITDA profit for the lower volumes and mark-to-market movements of future hedges running through the PNL, the EBITDA profit for the quarter was at a decent level of 11.6 million euros.

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 better natural gas and heat sales driving the revenue growth. EBITDA profit of the segment declined on an annual comparison. The largest impact came from natural gas as the financial hedges made for gas transactions do not fall under IFRS hedge accounting framework, which means that the Profit and Loss statement is influenced by the daily price changes of all gas positions, not only by the final settlements. As of the end of September, gas prices in Europe were conquering new heights with gas prices close to or above 100 euros per MWh which is 6 to 7 times more than a year ago. The second largest item on the graph is Auvere compensation in the amount of 28 million euros. In the third quarter we reached an agreement with GE for the compensation of Auvere power plant's below contractual availability levels in the guarantee period which ran from July 2018 to August 2020. This item is compensation for unearned revenue for the mentioned period due to lower than foreseen contractual availability level.

Next, let's go over the cash flow developments on the next slides. To start from slide number 17, we have provided a bridge from EBITDA to operating cash flow for the ended third quarter. The operating cash flow was nearly 43 million euros higher than the EBITDA mainly due to CO2 and derivative instrument impacts, while working capital affected the cash flows negatively. For the wordking capital the high electricity prices have a negative effect as account receivables increased as of the end of the quarter due to the monthly cycle of client invoicing for consumed energy services. Also the Auvere compensation item of 28 million euros mentioned on the previous slide is included in the working capital column, as this amount was already received in Q4 last year but due to final agreement reached in Q3 this year, the sum was booked through the PNL statement in the ended quarter while having no effect on cash flows. From the CO2 impact roughly half is attributable to the provision effect as in the PNL statement the CO2 cost is made, but the actual cash outflow happens once a year when all the emissions of the group are bought out together. Also, the CO2 and derivative instrument impacts reflect the change in the hedge instrument market prices which moved favourably during the quarter. In addition, we managed to free most initial margins as a result of implementing a margin financing solution offered by SEB. Interest paid during the third quarter amounted to nearly 14 million euros which is pretty similar to previous years as in September we have the 2023 Eurobond interest payment date in the amount of nearly 12 million euros. The largest item in the other column were payments to the Jordan power plant project in the amount of ca 8 million euros. The Jordan project payments would normally fall under investment cash flows but due to 10% ownership in the project, the sums are accounted under operating cash flows according to IFRS to adjust for the equity method treatment.

On slide number 18, we have provided a comparison of last year's and this year's third quarter operating cash flow. As in the previous slide, working capital, CO2 and derivative instrument impacts stand out with exactly the same reasons. First, higher power prices have resulted in increased receivables from clients while inventory levels increasing as well slightly across all products. At the same time higher EBITDA had a positive effect with derivative instrument market price movements mostly related to CO2 and electricity were more positive this year together with the mentioned implementation of margin financing solution during the ended quarter.

The Auvere compensation agreement resulted in EBITDA profit increase of 28 million euros, and is booked under the column „Change in EBITDA". While actually being a non-monetary item, there is an adjustment in the same amount in the „Changes in working capital" column with a negative sign of -28 million euros from the total change of -64 million euros.

Moving on to slide number 19, there is an overview of the investments made during the quarter. Capital expenditure in the third quarter amounted to 60 million euros, which is 57% higher than a year ago. Although the distribution grid related investments are still the largest single item, investments to different development projects have picked up. During the quarter we made investments to new wind parks, and also to the new oil plant. Both of these serve as a cornerstone in moving towards a carbon neutral operation model. In September the final investment decision of a 75MW wind park in Lithuania was announced, following a 43MW wind park investment decision from the second quarter earlier this year. In addition to sums on the graphs, in the third quarter the acquisition of Imatra Elekter, the third biggest DSO in Estonia, was finalised for nearly 30 million euros.

Turning to 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 163 million euros. In September Enefit Green signed new loan agreements, more information on this can be found from our interim report. As of the end of the quarter, Eesti Energia group had access to 665 million euros of undisbursed loans, which are divided between the parent company and the subsidiary Enefit Green that is now listed on the Nasdaq Tallinn Stock Exchange.

On slide 21, there is an overview of the group's leverage ratios and debt repayment profile. On the back of strong operating cash flows and better EBITDA, the net debt to EBITDA ratio has declined to 3.1 times which is lowest since the end of 2018. The group's credit ratings remain unchanged, BBB- from Standard and Poor's and Baa3 from Moody's. At the end of October S&P affirmed the rating and outlook for Eesti Energia group. 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. The figures on the slide do not include the proceeds from the IPO concluded in October 2021. As a result of the minority listing of subsidiary's Enefit Green shares, the group received gross proceeds of 175 million euros which further reduce the net-debt to EBITDA metric to a level of around 2.5 times. For the upcoming quarters we expect the figure to increase as the Group is executing its investment pipeline.

Turning to the 2021 Outlook on slide 22, the Outlook has not changed from the second 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 over and active monitoring of the circumstances is continuing on a daily basis.

To conclude today's presentation, please turn to the last slide, number 23. Group's performance continues the recovery from the low levels of last year on the back of record high power market prices. Electricity segment has shown most improvement with distribution business also showing increasing volumes despite slight decline in EBITDA profit. Although shale oil profit decreased due to lower volumes and financial transaction impacts not covered by IFRS hedge accounting framework, the operations of oil production are going smoothly. All things combined, the quarter ended with a net profit of 17 million euros. That is all for the third quarter of this year, we are now ready to take your questions.

**Closing comments**

Thank you for listening and let’s see you again at the beginning of March next year, when we present our full year audited results.