Eesti Energia Unaudited Financial Results for Q1 2022

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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 2022 1st quarter financial results investor 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, CFO of Eesti Energia. I am glad to welcome you to our conference call discussing Eesti Energia's financial results of the 1st quarter of 2022. 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

Starting from slide number 3 we have provided an overview of some selected operational metrics. Continuing from last year, retail electricity sold in home markets of Latvia, Lithuania, Poland and Finland, exceeded those of Estonia with total retail electricity sales volumes increasing annually by 13% to 2.6TWh. Sold gas quantities however decreased from 1TWh to 0.8, which given the high gas price environment is not too surprising. Electricity production during the ended quarter increased due to generation from oil shale based hybrid power plants due to high electricity price environment and demand in the regional power market for flexible power production, while the renewable part of the generation was basically at the same level of 0.4TWh. As a result of higher flexible power production the CO2 emissions were also higher compared to same period of last year. Distributed volumes of the DSO network decreased by 6%. The main reason for lower distributed volumes was warmer weather, but we are also starting to see the effects of added solar capacities at historical consumer locations thus lowering the distributed volumes in case of sunny weathers. Liquid fuel production quantities were lower in annual comparison due to this year's more extensive maintenance schedules in the first quarter.

Slide 4

Now turning to next slide, slide number 4, as a consequence of high electricity price environment, sales revenues and EBITDA increased significantly compared to last year's same period. We have introduced a new definition of adjusted EBITDA which in the 1st quarter amounted to 127.3 million euros, nearly 86 million euros lower than the unadjusted EBITDA. The adjusted EBITDA eliminates the non-monetary effect from temporary fluctuations in the fair value of long-term Power Purchase Agreements, or so called PPAs. The reason we have eliminated this effect is because according to IFRS9 rules hedge accounting framework is not possible to apply in this specific case and therefore the total portfolio of signed and contracted PPAs must be revaluated according to latest price curve data. The latest price curve data is not based on publicly available market price curves as one would normally expect due to unavailability or very low liquidity of such publicly traded instruments for periods of 5 years and more years into the future, while the electricity sold onwards to consumers based on the PPA contracts are for periods of up to 10 years. Therefore, the latest price curve data is in-house price data knowledge based on latest prices of electricity that has been sold from PPA contracts to the consumer. According to IFRS9 rules the latest prices must be also applied to the already sold PPA quantities. We expect the EBITDA figure to remain subject to high volatility going onwards. In case the electricity price levels should decline compared to Q1 this year, we cannot rule out significant negative effects on EBITDA figures in the future.

Worth mentioning for the 1st quarter are also strong operating cash flows as generation units benefitted from high electricity price environment while a significant cost component, the CO2 emissions cost occurs as a cash item usually in the 4th quarter although being accounted for in the PNL statement. Also there were temporary working capital effects related to gas deliveries which impacted operating cashflows of Q1 this year positively, but this effect will be eliminated as the year moves ahead.

Slide 5

On to slide number 5 we will cover the electricity market. First quarter can be summed up as continuing high energy price environment, although prices declined slightly compared to the previous quarter. Still, year-on-year Baltic electricity prices were around 2.5 times higher and spreads between different Nord Pool pricing regions widened suggesting to insufficient interconnection capacities. Price spread between Estonia and Finland was at historical high in the first quarter, nearly 42 euros per MWh due to congestion in the interconnections owned by the transmission system operators. The increased price spreads are even more notable given no significant outages of the interconnections during the quarter, and taking into consideration the absence of stable operations of the Olkiluoto 3 nuclear power production unit in the amount of 1600MW. Latest estimate for regular electricity production at the new Olkiluoto facility is this year's September.

Despite 120% rise in the price of CO2 emission allowances, the overall market price environment for the operations of group's flexible hybrid power plants was favourable as the variable cost of gas fired power plants has increased significantly during the last 6 months and the market is looking for cheaper production possibilities. The same story is also illustrated on the graph by the positive Clean Dark Spread, and average sales prices achieved by the subsidiary Enefit Power owning such flexible power production assets.

Slide 6

On slide 6 we have provided an overview of the oil markets. Oil market prices continued rising and have now increased nearly for 2 years in a row. As seen on the graph, the Q1 price increases were especially drastic as the result of Russia's war on Ukraine from 24th of February. At the same time we have seen OPEC not increasing its production either as a result of unwillingness or low investments made during the COVID-19 pandemic period. Whatever the reason, the end result is higher oil price environment. Movements of brent and fuel oil were comparable in the first quarter, both rising in annual comparison around 60%.

Slide 7

Now let's move on to the financial overview of Group's results, so kindly turn to slide number 7. Both sales and EBITDA profit of the Group increased with electricity segment being the main driver on the back of high electricity market price environment. The EBITDA figure here shown is the unadjusted figure. When adjusting for the PPA effect, the electricity segment EBITDA increase on annual basis was ca 81 million euros lower at roughly 42 million euros which still is a very decent result. DSO segment's performance was hampered by lower distributed volumes and higher electricity purchase costs due to high price environment. Shale oil segment's revenues and EBITDA declined due to lower production quantities as a result of significant maintenances this year and hedges made from lower price levels. The Other products and services segment mostly benefitted from gas sales as gas prices were significantly higher compared to a year ago effecting also revenues and profits in annual comparison together with effect from gas hedges running through the Profit and Loss Statement.

Slide 9
To cover the electricity segment, please turn to slide number 9. Sales revenues of the electricity segment rose by nearly 2.5 times from 148 to 364 million euros mainly due to high price environment. Also electricity sales quantities had its part by increasing nearly 13% annually driven by good retail sales activity in all of our home markets, especially in Poland, Lithuania and Latvia. As seen in previous quarters, average electricity sales price achieved by the Group increased but to a lower extent compared to NordPool market prices due to fixed price contracts on the retail portfolio. At the same time prices achieved by controllable power units are higher compared to market's average price due to production aimed at peak hours. However, since retail sales quantities are larger than electricity generation quantities, the average electricity sales price of the Group remains below market average. Electricity generation during the quarter increased by nearly a third to 1.7TWh due to demand for oil shale based production from Group's hybrid power plants. Although wind conditions were favourable during the quarter, renewable electricity generation which also includes electricity production from waste wood at hybrid power plants was basically at the same level as year ago due to high biomass and waste wood market price environment which decreased the usage of such fuels in our hybrid power plants.

Slide 10
Moving to the next slide, electricity EBITDA development is shown. On this slide we have once again used the adjusted EBITDA figure to show the impact from the before mentioned revaluation of PPA contracts which is inside the Other column. The only red column on the graph relates to fixed costs as the internal cost division for mining is based on oil shale usage which was higher for electricity production this year. This larger share of allocated costs is then again offset by larger revenues of the electricity segment. Although margin impact was +21 million euros positive, inside the column there are significant movements in both directions detailed in the first bullet on the graph. Large positive impact comes from high electricity prices, while the group also has to purchase electricity for its retail portfolio at market terms for market-based contracts and this shows up in the significantly higher variable cost together with the CO2 costs for the flexible hybrid power units. All in all, the electricity segment's result was very strong.

Slide 12
Carrying on to slide number 12, let's go over the distribution segment which saw 6% smaller volumes in the first quarter of this year compared to year ago. Lower volumes can be traced back to warmer weather compared to last year's beginning of the year. The high electricity price environment also motivated some customers to consume less electricity, as the average sales price increased mainly due to a larger share of fixed price component in the total revenues which is a result of lower consumption volume at client premises. Also, from March 2022 new tariff packages were introduced as a result of which average tariff increased by 3%. In June this year a further 10% average tariff increase will take place, as already approved by the Competition Authority, due to 17% rise in the tariff of the transmission system operator.

Slide 13
So turning to next slide, the overview of distribution EBITDA has been provided where the largest negative impact in annual comparison came from costs related to network losses. Lower volumes effected EBITDA negatively by 2 million euros, while rise in fixed costs is traceable to maintenance costs due to more severe weather and as a consequence larger scale maintenance works. For the higher cost component of network losses, this will be included in the next tariff applications in the future. In Estonia there are no set regulatory

periods, therefore the DSO can submit an application to the Competition Authority for a new tariff basically at any time.

Slide 15

Next, let's move on to shale oil Operations on slide 15. Although production, and as a result sales quantities and revenue for this year first quarter fell due to different maintenance schedule compared to last year, we are still witnessing good demand for our liquid fuel products. This is portrayed by the premium received when comparing the average shale oil sales price to market price of heavy fuel oil.

Slide 16

Moving onto next slide, the columns that pop out are „margin impact", „gain on derivatives" and „other". All those columns relate to market price development and hedges, but from different angles. Margin impact shows the impact of higher market prices, which due to hedging activities should be looked together with the „Gain on derivatives" column. This year's hedges were made in 2020-2021 from lower price levels with average price around 300 euros per tonne for fuel oil and 340 euros per tonne for gasoline fraction of the production. Compare those prices to current market prices of 500 euros per tonne and the result is the column „Gain on derivatives" on annual comparison basis. The „other column" includes the change in the value of unrealised gain of derivative instrument in annual comparison to last year's first quarter when there were negative impacts in the amount of 9 million euros to the market value of hedges that are no longer affecting PNL Statement due to implementation of Hedge Accounting framework from the beginning of this year.

Slide 17

On slide 17 we will cover Other products and services. The main impact here came from gas sales that were largely affected by market-price based contracts that were covered through inventories purchased last year before the heating season which is a natural course of gas business. This year the effect of purchased lower price gas came in with leverage as gas prices started rising significantly from last year September, October. Also, the gas EBITDA benefitted from derivative instrument effects, but in broad terms the gas segment showed strong organic performance during this year's first quarter. Heat EBITDA declined mostly due to smaller sales volumes as warmer weather than last year declined demand for district heating services while increased CO2 market prices further pressured heat's earnings.

Slide 18

On next slide we have provided a comparison of 2021 Q1 EBITDA and Operating cash flows. Operating cash flows were nearly 59 million stronger due to working Capital and CO2 impacts, which were offset by the derivative effects mainly related to the before mentioned non-monetary revaluation of PPA contracts as here on this graph the bridge is shown between operating cash flows and EBITDA, not adjusted EBITDA. CO2 positive impact came mainly from CO2 related provisions posted in the Income Statement while the actual purchase for cash happens usually at the end of the year, thus a positive effect for quarterly cash flow. Changes in working Capital are mostly related to gas deliveries which have payment dates after quarter end, thus affecting the cash flows positively for the first period at hand.

Slide 19

Moving onwards to the next slide we have compared first quarter operating cash flows from 2022 to 2021. The main factors are the same as on the last slide, in addition the stronger EBITDA which should be looked together with the column of Derivative instruments as this column includes the much mentioned non-monetary revaluation of PPA contracts. When adjusting both columns, the net effect from stronger EBITDA was around 45 million euros.

Slide 20
To cover the capex overview, let's turn to slide 20. Investments during the quarter increased from 32 to 59 million euros mainly due to increased investments to the different development projects led by new renewable asset developments in Lithuania, Finland, Estonia, and also the Enefit-280 chemical plant. One of the main receivers of investments is still the distribution network to which 21 million euros was invested. From this amount 14.3 million euros went to improving connections that will enable to add more solar production units to the network. By the end of the quarter 405MW of solar capacities were connected to the distribution network, compared to Estonian national peak demand of around 800 to 1000MW currently in the month of May. During the 1st quarter final investment decisions were made regarding a 21MW wind park in Estonia, and a 6MW solar park in Poland – both of those Projects are expected to be commissioned during next year.

Slide 21
Turning to slide number 21 an overview of the Group's liquidity position is provided. At the end of first quarter 2022, Group's cash position amounted to nearly 306 million euros, and have sufficient liquidity buffers considering the volatility of the energy markets and upcoming investment commitments.

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 of Enefit Green in October last year, the net debt to EBITDA ratio of the Group has declined to 1.3x. The net debt to EBITDA ratio using the adjusted EBITDA metric is 2.0x. The decrease in net debt to EBITDA metric, also on an adjusted EBITDA basis, has been to some extent unexpected but clearly shows the volatility of the operational environment and company's performance during first quarter. As was the case 2 months ago, for the upcoming quarters we expect the net-debt/EBITDA ratio to increase as the Group continues the execution of its investment pipeline.

The group's credit ratings remain unchanged compared to previous investor call, 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.

Slide 23
Turning to the 2022 Outlook on slide 23, the management of the Group expects growth in sales revenues, EBITDA and investments. Growth in Group's sales revenue is expected mostly from higher electricity market price and volumes. Expected EBITDA is now expected to increase, compared to decrease expectations 2 months ago due to strong first quarter performance. 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 the first quarter of 2022 resulted in a record first quarter turnover of above 570 million euros, nearly half from last year's total revenue on the back of high electricity price environment despite increased volatility in the daily prices of electricity. Electricity segment was the clear driver of the results, with distribution and shale oil operations suffering both from the effects of lower sales quantities, but of course for different reasons. The first quarter results were significantly impacted by the non-monetary revaluation of PPA contracts, and therefore we have introduced the terms adjusted EBITDA and also adjusted net profit. Both showed significant improvements from year ago levels. At the end of April the

annual general meeting also confirmed the net dividend payout to the sole shareholder in the amount of 46.7 million euros. The Group is expected to pay total dividends in the amount of 55.7 million euros during this year, which also includes the Tallinn stock Exchange listed majority owned Enefit Green dividends payable to its minority shareholders in the remaining amount of ca 9 million euros. Overall the Group’s management assesses the Group to be well balanced for current highly volatile environment due to Group’s diverse asset structure.

Question and answer session

Ladies and gentlemen, at this time, we will begin the question and answer session.

If anyone wishes to ask a question, please use the “raise hand” feature or write a question to the chat. Thank you.

Seems that there are no questions at this moment.

Closing Comments

We would like to thank you for listening and let’s see you again at the beginning of August when we present our 2022 second quarter results. Thank you all.