Eesti Energia Unaudited Financial Results for Q2 2022

4 August 2022
Transcription

Introduction by Rasmus Noormägi

Dear ladies and gentlemen, hope there is no echo at this moment. Apologies for the technical disturbances. My name is Rasmus Noormägi, Head of Investor Relations and Treasury of Eesti Energia. Welcome and thank you for joining Eesti Energia's second 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, please write them in the chat, or after the presentation we are available for a Q&A session. We will be also showing the slides on the screen as we go along. The report together with the presentation are available at our website.

Unfortunately our CFO was not able to join us today, so the investor call shall be covered from my side.

Slide 3

Starting from slide number 3 we have provided an overview of selected operational metrics. The picture is pretty similar to the first quarter with the same trends of high energy prices continuing to shape the markets and the operations of the group. Sales volumes of the retail business from outside of Estonia continue to increase and now make up 58% of volumes. This is in line with Group's strategy and up from 54% both a year ago and in the first quarter of this year. While distribution volumes were stable, electricity production saw significant increase in production from non-renewable assets which are the dispatchable oil shale based hybrid power plants. The increase in the usage of the dispatchable oil shale based hybrid power plants comes as direct consequence of a tense power market situation where gas prices have pushed electricity prices north of 200 euros per MWh on a constant basis. Eesti Energia as the holder of reserve power supply assets in Estonia, needed to operate older asset base during the quarter as a direct consequence of the high electricity price environment providing electricity not only to Estonia, but also to the Nord Pool region. The older asset base consists of PC, Pulverised Combustion, units that have been modernised but still are less flexible on the intake fuel and have higher CO_2 intensity figures compared to the more modern and flexible CFB units. Those older PC units have been kept for the sake of reserve security of supply, and saw utilisation in the second quarter, pushing up non-renewable electricity production and CO_2 figures. In the normal circumstances of the power market those assets would not be used, but today every MWh of electricity produced from other sources than gas is highly welcomed on the market as most likely it is cheaper.

Slide 4

Now turning to next slide, number 4, a brief overview of main financial figures has been provided with significant increases in all fronts. Again, trends are similar as seen in the first quarter of this year. The high electricity price environment continues to support the ongoing operations while the Group continues to develop its asset base through investments to renewable energy, distribution network, and chemical Industry transition through the construction of a new Enefit280 production facility. Investments of the group continue to increase and were just shy of a hundred million euro mark. These investments help to increase the energy independence and generation of affordable and environmentally friendly electricity in the region.

Quarterly operating cash flow increase on annual terms was affected by the low comparison period as the CO_2 allowances purchase was postponed from the end of 2020 to the second quarter 2021 in the amount of nearly 100 million euros. Even when adjusting for this item, the 2nd quarter operating cash flows of this year were very strong.

In the first quarter of this year we introduced a new definition of adjusted EBITDA which in the 1st quarter was nearly 86 million euros lower than the reported EBITDA at 127 million euros due to non-monetary revaluation of long-term PPA contracts. The effects in the second quarter were lower, with difference between reported and adjusted EBITDA at nearly 12 million euros. The streaked area on the EBITDA graph shows the impact from this specific item. We provided more detail into the accounting specifics of the topic in the first quarter investor call, so those who wish may find the recording and the transcript from our investor webpage.

Slide 5

To cover the markets, please turn to slide number 5. Let's start with the electricity market, where the high price environment has continued. The most talked about factor for the high power prices is gas which due to current 200 euros per MWh market prices take the gas fired power plant variable cost to around 400 euros per MWh. As in most parts of Europe, gas power units are used for peak electricity production also in Latvia and Lithuania. Therefore gas is the major reason for high electricity prices in the region due to lack of alternative electricity production facilities. Secondly, during the quarter we saw a stoppage of electricity inflows from Russia to the Nord Pool region. Earlier periods have seen significant electricity inflows to the NordPool area from Russia through Finland and Lithuania via Kaliningrad. Thirdly, an important factor on the significant price spreads between different countries are the interconnection capacities. During the quarter there were significant limitations on the Estonian-Latvian border connections while the two Estlink cables between Estonia and Finland were operational, however congested most of the time.

The dark blue dotted line on the graph, the Clean dark spread of Eesti Energia's dispatchable hybrid power units continues to be supported by high electricity prices, while CO2 prices at 80-90 euros per tonne and higher oil shale costs have taken away nearly 80%* of the high electricity price benefit. In the first quarter we also pointed out the effect of added solar capacities in Estonia which took prices during daytime below 100 euros per MWh. As second quarter was quite sunny and alleviation of prices could have been expected, this was not the case due to significant maintenances of base load power production units in the Nordics, and also for our units. In addition, as Latvia and Lithuania are in a larger deficit of electricity than Estonia without dispatchable reserve supply assets, the surplus electricity in one region is transported to the deficit area and this pushes the prices higher also for the surplus areas.

Slide 6

Moving on to slide 6 we have provided an overview of the oil markets. Oil market prices have continued their stairway with the same trends and factors as in the previous quarter with brent and fuel oil have moved in similar fashion. Form what we see, there are currently 2 main factors shaping the global oil market. On the one side we have Russia's military assault on Ukraine with Europe's intention to lower energy dependence on Russia, and at the same time there still seems to be globally insufficient supply due to limited spare production capacities.

Slide 7

But now, turning to slide number 7, let's start the financial overview of Group's results. As mentioned, the picture is very similar to the first quarter, both sales and EBITDA profit of the Group increasing with electricity segment being the main driver due to high electricity market prices. DSO segment's profitability was held back by the same reason of higher electricity market price, as this effects the purchase costs of network losses. The associated higher electricity purchase costs are not yet reflected in the current regulated tariff to full extent. Shale oil segment's revenues were stable due to hedges made from lower price levels a year ago despite 3% higher quarterly sales volumes. Shale oil EBITDA was affected by increased variable costs which kept the shale oil segment in the negative EBITDA territory. The Other products and services segment mostly benefitted from gas sale revenues due to significantly higher gas prices while sold gas quantities were at a similar level as a year ago. Also there were additional profits of nearly 7 million euros from the provision of frequency reserve services which is a new revenue stream for the Group.

Slide 9

As usual, let's start the coverage with the electricity segment. So please turn to slide number 9. Sales revenues of the electricity segment rose by nearly two times from 127 to 253 million euros mainly due to high price environment, but also thanks to 20% higher sales volumes with retail sales increasing by 21.3%. Retail volumes have increased in all markets with Latvia's volumes increasing the most at 56% in annual comparison. Other markets have all seen at least 10% increases in volumes. On the electricity production side volume was 56% higher than a year ago in the second quarter due to utilisation of reserve security of supply assets. Although wind and solar electricity energy production increased on annual comparison by slightly more than 4%, group's renewable electricity generation fell by 3.6%. The reason is lower production of electricity from waste wood and biomass which fell by ca 15% due to tense biomass market situation as the availability of the resource at reasonable price levels is a challenge. In addition, the utilisation of older reserve security of supply assets implies also less power generation from waste wood as these units are less flexible on the Intake fuel mix compared to the more modern CFB units

Slide 10

Moving to the next slide, number 10, electricity EBITDA development is shown. The solid dark blue column is the reported EBITDA, with the streaked column showing the impact from revaluation of PPA contracts. The only red column on the graph, the fixed costs, was impacted mainly by higher payroll costs. The biggest positive effects came from realised hedging impacts which are in the column of „Gain on derivatives" as average sales price including derivatives was higher than without hedging impacts due to production related hedges. Second largest column, „margin impact" was ca 10 million euros positive, but inside the column there are significant movements in both directions detailed in the first bullet on the graph. Large positive impact came from high electricity prices for the production units, while electricity purchases for the retail portfolio at market terms for market-based contracts increase the cost side. Also, higher CO2 costs for the flexible hybrid power units effect the variable cost negatively. All in all, the electricity segment's result was very strong with adjusted EBITDA at nearly 55 million euros, and the reported figure nearly 12 millions higher.

Slide 12

Moving onto the distribution segment's performance, please turn to slide number 12. Distribution sales volumes decreased annually by 1.5%, with the added solar capacities being on of the culprits. The exact impact from added solar capacities, which now stand at 545MW vs 405MW at the end of last quarter and 385MW at the end of last year, can be derived but there is no exact figure. The reason is that the lower consumption of the consumers due to installed solar capacities does not show up in the metering data received by the DSO, because the system is built up on net consumption or production numbers. Therefore, for most of pronsumers lower quantities can be seen but what are the effects from lower inherent consumption or self-produced quantities, is unclear.

Turning attention to sales revenues, the increase can be traced back to the average tariff. This year there have been 2 tariff increases so far, and a third one will come from 1st October with an additional 3% rise compared to the current tariff levels. 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. All three tariff changes are tied to higher electricity purchase costs as a direct result of higher network loss costs. One tariff increase also included the impact from the rise in the Transmission System Operator's tariff. On the bright side, the reliability of the network has been better from last year with network losses and interruption durations both improving.

Slide 13

Turning to next slide, the overview of distribution EBITDA has been provided where the picture once again is very similar to first quarter results. Largest negative impact in annual comparison came from costs related to network losses with lower volumes and fixed costs also decreasing profits.

Slide 15

Next, let's move on to shale oil operations on slide 15. Production quantities increased by nearly 10% from last year's levels as there were fewer planned maintenances this year. Shale oil sales volume was about on the same level as production during the quarter, with year-on-year 3% rise in sales volumes. Sales revenue of the segment continues to be held back by hedges done from lower market prices from last year. On the bright side we are seeing good demand for our liquid fuel products 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" with all in the same magnitudes as three months ago in the first quarter. „Margin impact" column includes the market price effect without hedges and also the negative effect from variable costs. The remaining two bigger columns relate to hedges, but from slightly different angles. „Gain on derivatives" column includes hedging impacts for the quarterly sales quantities, while the „Other" column includes the change in the value of unrealised gain of derivative instrument in annual comparison. A year ago there were negative impacts in the amount of 9.5 million euros to the market value of hedges that are no longer affecting the PNL Statement due implementation of Hedge Accounting framework from the beginning of this year.

Slide 17

Please turn to slide number 17 to cover Other products and services. The main reason for the higher sales revenues were gas sales that are nowadays largely affected by market-price based contracts. On an annual comparison basis gas EBITDA also benefitted from derivative instrument effects. Heat EBITDA declined mostly due to increased CO2 emission costs while a new revenue stream, frequency restoration reserve service, or FRR in short, ended up in 6.8 million euros contribution to revenues and EBITDA. This is a service offered by Group's dispatchable hybrid power plants to transmission system operators in Finland, and Estonia from the start of this year. The nature of the service is to offer TSOs additional capacities for keeping the electricity system's frequency in balance through ramping the production units up or down based on the necessity.

Slide 18

On next slide, number 18, we have provided a comparison of this year's second quarter EBITDA to Operating cash flows. Operating cash flows were 211 million euros stronger mainly due to CO2 and derivative instrument impacts. CO2 positive impact comes from two places.

Firstly, ca two-thirds of the CO2 positive impact came from CO2 related non-cash provisions posted in the Income Statement while the actual purchase for cash happens usually in the end of the year. Thus the positive effect on the quarterly cash flows compared to EBITDA profit. Secondly, ca one-third of the positive effect came from received mark-to-market moves that represent the market price movement of CO2 allowances at the commodity exchange due to Group's long position in CO2 instruments. Other hedging related derivative instruments also witnessed positive cash flows during the quarter. Most of this came from the electricity instruments were forward price curves have significantly increased and again the group received relevant mark-to-market collaterals in cash. Third largest column on the graph is tied to the working capital changes where largest negative impacts came from higher collateral margins required for hedging instruments, and also inventories somewhat increased. This year's second quarter saw dividend pay out in the amount of 46.7m euros to the sole shareholder, State of Estonia, and to Enefit Green's minority shareholders in the amount of nearly 9 million euros. The Associated income tax expense was lower than the Estonian tax rate on dividends as the dividend pay out included mainly of dividends paid out from entities registered in other countries where dividend taxes had already been paid in earlier periods.

Slide 19

Moving onwards to slide number 19, we have compared second quarter operating cash flows from this year to last year. The main factors are the same as on the last slide, in addition the stronger EBITDA figure of nearly 51 million euros. Income tax difference is due to dividend pay out in this year, while last year no dividends were paid. The CO2 column on this page is higher than on the last page due to CO2 purchase allowance from last year's second quarter while this year there was no such effect. The CO2 allowances that were surrendered this year were bought out in December 2021.

Slide 20

Next, let's cover the investments. For this, please turn to slide 20. Investments during the quarter increased from 54 to 98 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. Distribution network remains one of the biggest recipient of investments where the significant share goes to improving connections that will enable to add more solar production units to the network. During the quarter the Group made a final investment decision on a 32MW solar park in Estonia, and updated its strategic goals. Previous commitment for 2025 was to add 600MW of new wind and solar capacity, and this still stands. With the update to the strategy, the Group has taken new ambition to increase Renewable capacity to nearly 1900MW by the end of 2026 from the current 457MW.

Slide 21

Turning to slide number 21 an overview of the Group's liquidity position is provided. At the end of second quarter, Group's cash position amounted to nearly 437 million euros. In addition the group has access to nearly 700 million euros of undisbursed loans. The liquidity position of the Group is expected to stay strong despite decrease expected in the second half of the year due to investments and working capital requirements which mainly relate to the CO2 allowances purchase currently forecasted for the month of December, but with possibility to postpone the purchase until next year's April. We would like to stress that the group is conscious of the liquidity buffers required 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 in October last year, the net debt to EBITDA ratio of the Group has continued to decline and is now below 1.0x. We expect the net debt to EBITDA ratio to increase by the end of the year due to investments and working capital requirements.

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 Outlook is unchanged from the end of first quarter. Growth in Group's sales revenue is expected mostly from higher electricity market price and volumes. EBITDA is expected to increase as well, as power prices and volumes are supportive, and also a significant boost from Power Purchase Agreement revaluations realised in the first six months of this year in the amount of nearly 98 million euros. Investments are expected to grow from the levels of 2021, with increase expected from renewable energy developments, larger distribution network investments and the construction of the new Enefit280 production facility.

Slide 24

To conclude today's presentation, please turn to the last slide, number 24. Group's performance in the second quarter of 2022 resulted in a strong second quarter turnover, 73% higher than a year ago. EBITDA levels saw more than two time increases on both reported and adjusted basis. Second quarter ended with a decent net profit of 45 million euros, with adjusted net profit 12 million euros lower at 33 million. Electricity segment has been the clear driver of the results due to extraordinarily high market prices. The strong financial performance enables to carry out investments with focus on affordable renewable energy solutions in line with the long-term strategy of the Group. Year to date investments are nearly two times, or 71 million euros higher from last year's levels. During the second quarter dividends were paid out to the sole shareholder, state of Estonia, in the amount of nearly 47 million euros. Total paid out dividends amounted to 55.7 million euros, with 9 million euros attributable to the Tallinn Stock Exchange listed majority owned Enefit Green's minority shareholders.

Ladies and gentlemen, with this we conclude today's presentation and we are now ready to take your questions. Anyone who wishes to ask a question, please use the "raise hand" feature or write a question to the chat.

Closing Comments

Seems that there are no questions at this point. So on behalf of Eesti Energia I would like to thank you for listening and see you again at the beginning of November when we present our 2022 third quarter results. Thank you