

Eesti Energia “Release Q2 2012 financial results” Conference Call

MODERATORS:
MR. MARGUS KAASIK, CFO

Margus Kaasik: Hello. My name is Margus Kaasik; I am CFO of Eesti Energia. I welcome you all to a conference call on the results of Eesti Energia for the second quarter of 2012. Now, without any further delay, let us straight jump to page three where is highlighted our results for the last quarter, and what we see here is that our revenues have declined somewhat 14 percent. We will come to the reason later on; particularly half of that decline was due to one-off items from last year. We saw healthy growth in our EBIT and even more healthier growth in operating cash flow that we are extremely glad of and also, we saw a slight decline in the investment side that did mean that the quite substantial drag on our cash balances that we had last year; decreased quite significantly over last quarter. But we are still cash flow negative - currently and in the nearest future.

On the next slide: a bit about our power market, Nord Pool Estonia. I think that the two things that I would turn your attention to first is the dark clean spread that you saw on the graph, the orange bars there. And what it does show that although the prices have declined quite significantly over the last, let's say two years, the spreads that we get on the power market are still very healthy, very good: EUR13 during the last quarter, per MWh. That is quite a good margin, and on the margin side we are still doing very, very well. The second point to address here is that the Baltic power price is – in the Baltics, as a whole and also in Estonia - seem to be a lot more stickier or less volatile than they are in the Nordic countries. It does mean that we do see much less spikes here, for instance last year - the beginning of last year - when there were quite high prices in the Nordics, and they did not go at all at those levels here in the Baltics. The differences between the Baltic and Nordic price area was between EUR20 per MWh then, but now it is vice versa when the prices in the Nordics have declined to even less than EUR10 per MWh. Here in the Baltics we still see 30 to EUR40 per MWh. So, the prices are, here, much more comfortable and much less volatile than they are in the Nordic countries.

Now turning to page five, on the revenue side, as I already indicated the revenues declined 14 percent, close to EUR30 million. A bit more than half of it was due to one-off items. We had non-recurring revenue from sales of Jordan Project from last year's second quarter, and that amounted to EUR16 million. Two of our other products, electricity and oil, were also in decline. We sold less electricity and sold a bit less oil as well, but that was, to some extent, offset by increased revenues in distribution side. So, the new network tariffs that we got last year did increase significantly the distribution revenue. And that is the regulated bit of our business and also most important to us.

On the next slide – slide six – now we turn to product overviews and firstly, the regulated electricity market comments - there is not much comment there. The prices are basically the same as they were a year ago. Consumption in the regulated market also had not changed much - well, by a two percent increase - but what to comment is that the market is fully liberalised from next year. Last necessary bit for market to open, the changes into electricity market law has now been done. They were done; Parliament passed the law on 6th of June this year. So all the framework, now, is accepted. I think one of the most important aspects to us in this law is how the public supply would work or how those people who do not choose their supplier, how they will be supplied from next year and the good news is that the public supply is tied to Nord Pool spot price in Estonia plus a margin that the seller would like to get. So, there isn't any cost-based energy available for consumers or we are not obliged to sell at cost base from next year on. It all will be linked to power exchange prices.

Now, if we turn to the next slide: seven - about the open market, or eligible market in the Baltics - then, mainly good news. As on the retail side we have sold more, retail sales have now grown 87 GWh; quite significant. We did increase significantly our market share in Latvia, we were very successful. They had a next wave of market opening this spring and we were able to catch quite a lot of customers there. In Estonia, our market share, still, is around 70 percent and in Lithuania the market share has stayed below 10 percent. On the power exchanges and wholesale market we sold a bit less, as the wholesale prices on the market were less than at some point of time that we liked, so we generated less, but nevertheless the average price that we were able to get on the open market side was quite good. Despite the fact that the prices on the markets were in quite significant decline, we even got a bit more out of it and most of this is due to good hedges that we had in place. Hedges to retail market, hedges on the financial market and all in all the price that we got for 40, close to EUR49 per MWh, I think, was a very good accomplishment for us. And lastly, as we were also able to increase the renewable generation then we also got more from a subsidy: EUR11 million - we got from renewable energy. Subsidies mainly came from Biomass generation, from biomass and oil shale co-firing.

Now onto slide eight, about distribution network. Our distribution revenues increased quite significantly. The volumes did not grow much, but even actually that three percent increase in distribution network is quite remarkable and is quite good for us. But of course, most of the increase in the revenue side came from the price increase. Our distribution network got new tariffs from August last year. That was the main driver behind that but the prices have changed, also, later on but then it was only due to pass-through elements. So, prices from 1st of January, transmission grid company increased its tariffs and, of course, that also triggered the increase in our distribution charges, but that did not give anything to us on a margin side. And also on the distribution side was this good to report in that our network losses are low. They are at historically low levels here, now and on the last quarter they were just a bit over 4 percent, 4.1 percent; very good levels for us. And looking at what is the network configuration here and the twelve-month average figure was also below 6 percent, so very good and low losses on our end.

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On slide nine, we are now turning to oil sales and here we saw also somewhat decline. We produced less oil. We had a little longer maintenance period this quarter and we produced a bit less oil and prices declined a tiny bit. So, all in all, the revenues from the oil sales did decline by 22 percent.

Now, on the next slide about other revenues: other revenues saw a significant decline. Most of it was due to one-off items from last year - that revenue from Jordan business sales and revaluation. But also, we had less sales in our technology industries, the business company that is also building an oil plant. As the oil plant is now close to completion then the construction volume has declined significantly and also the works at our subsidiaries have declined and secondly, we sold our telecommunication business and that declined the other revenues, as well.

Now, enough about the revenues. If we look at the costs – this is on slide eleven – then we have revenues declined but happily, the costs declined even more and I think things to note here, of course, is that the post opex cost due to volume decreases, of course, decreased as we generated less electricity, sold less oil, then that did command some decline in the variable cost, as well. We had a more significant decline in the price side, as we got significantly more CO2 from last year. We had a better allocation now for this year so that in effect meant that this year basically we did not need any CO2 allowances beside the freely allocated ones and therefore the various costs of CO2 did decline to zero for us and that did boost, significantly, our cost reduction. Also happy to report that our fixed expense were down EUR4 million and also there were some non-recurring expenses - or there were some expenses. We made some provisions last year, during last year's second quarter, that we did not do this year or did not need to do this year and that also contributed to some one-off items and all in all we saw a significant decline in the cost side.

Now, when we turn to EBIT – next slide, slide twelve - we saw EBIT growing from 37 to 42 and here, basically, you see that most of that growth came from our generation business unit where profitability grew significantly. And also, from our distribution network, in the fuel side, there was quite a significant decline, but as I always told, big part of it, basically 16 million out of the 21, was due to those one-off items from last year.

Page 13, about the profitability of our business segments: on the retail side not much difference. We did a bit better on the retail market; we sold more energy. That did give us a bit more marginal profit also the profit margin itself, the sales margin, was slightly better this year than it was last year. All in all, in the electricity markets, we earned EUR1.6 million more, but the EBIT was reduced by the fact that we sold the telecommunication business and the profit of that business unit was EUR1.1 million last year, so that is what we did for this year.

On the distribution network side, we saw quite a healthy increase in profits. The return on invested capital for distribution network was 7.4 percent. So, when we previously – last year's revenue report is that the profitability of the distribution network was very, very low. That was mainly due to the fact that the sales volumes had declined significantly. The sales volume risk was on our side and therefore with those tariffs we were not able to earn the reasonable return in the distribution network. Then after the new tariffs, now, we are basically very, very close to the level that the regulator has approved to us. We are quite happy with the results that we have got from the distribution network.

On slide 15, if we look at the generation business, then there we saw quite a significant increase in EBIT or in profitability and a large part of it was due to reduced CO2 costs as the CO2 prices have gone down. We have a better allocation now; then that did contribute significantly to our bottom line and also this provision that we did last year, but did not do this year, did contribute significantly. So, all in all, we see - even despite the fact that we generated less and that had a negative impact on our profitability - altogether still, we saw a - quite a substantial increase in the profitability in our generation side.

Next slide on the fuels division: the biggest impact here or the biggest reason for decline for those on-off revenues from last, but we also did see a reduced profitability in our mining side and in the fuel side, oil side. It is mainly because the variable costs in the mining have increased. There are some taxes that have increased, and so on. And as the prices for oil shale are basically the same as they were the margin has been reduced in the mining side and also in the oil side. As the volumes have decreased, that has commanded a decrease in oil profitability. We have tried to offset it as much as we could by reducing the fixed costs. But that does not help that much, but we do see, of course, better prospects for fuel division in the second half of this year when we both see more demand for oil shale in the power generate side and we also expect the new oil plant to come online so we do expect that this division will do better with the next half of the year.

Slide 17, just mining separately. All this does show that the EBIT was decreased about EUR1 million and the main reason for the decline was this decline of the sales volume.

Now, if we look at the slide 18, and look at the effects, all those effects on our profitability on a consolidated basis, then we see that the higher profitability in the distribution network and higher profitability in electricity sales were the main contributors to the EBIT growth and then if we look at what was the main reasons that did held back the decline in growth even further, were higher depreciation, lower oil profitability and also those non-recurring items; that netted to EUR8 million altogether. But, all in all, we still were able to increase our EBIT from 37 to 42 and that is quite a good result keeping in mind that the volumes of our main sales products were in decline during this quarter.

Now turning to the cash side – slide 19 – the cash flow looked better this quarter than it did last quarter. If we look



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how the cash flows from operations derived from EBITDA then we see quite logical steps. We were quite happy that we got quite a substantial decrease in our receivables and other current assets. That did free up cash EUR14 million. We had some - tied up our cash in the liability side - which was 25 million - and then, as we generated much less, but we tried to mine still the oil shale as much as we can our inventories - especially oil shale inventories went up - and we had some cash tied up in the inventories side and we did some provisions, as well. Then we saw that our cash flows from operations were EUR47 million and they were derived from EBITDA of EUR70 million.

But if we compare it to the last year – that is on the next slide, slide 20 – then, compared to last year we saw a significant increase in the cash flows. They were increased from 26 to 47 million and part of it was due to the fact that EBITDA did grow although the growth was mainly due to non-monetary items. So, we could say that most of this growth in the cash flow was because we had a lower working capital and we were able to free some cash from the working capital side.

Now looking at the CAPEX –slide 21 – we invested EUR95 million during this quarter. Biggest part of the investments went into distribution networks, that was EUR23 million, to upgrade the lines and substations and improve the quality of our service to the clients. Then were some projects that were in near to completion: wind plant, for instance or new oil plant. These are all nearing the completion term and also, we made a substantial project of new power plant. That is where we invested EUR14 million during this quarter. On the investments, more can be said on the next slide, slide 22, the progress of those main investments that we do. The Enefit oil plant is under cold commissioning already and, basically, the mechanical completion is achieved and now there is a time for cold commissioning. The hot commissioning should start quite soon and we expect first oil in September. That is quite important investment especially taking into consideration that we want to expand the oil industry further. Then we have desulphurisation equipment in Narva power plant, we are mainly done. Now we are adding lime injection system into that machinery there to make those filtration systems more flexible and more efficient and it should be ready by the end of this year. And Narva Wind Park, Paldiski wind park, basically, are ready now. We see the – we see only the transmission grid or system operator tests coming on, after what we can start receiving the renewable subsidy, but basically they all already working and generating energy. Iru waste-to-energy plant already going very well; the main equipment is in place and then we are, basically, starting up the plant in the beginning of next year. The distribution network investment plan is going according to our schedules and plans. New CFB power plant in Auvere is also, well, already well above the ground. The structural works are taking place. And then we have two predevelopment projects both in Jordan and US where we mainly do the studies and the environmental work and baseline measurements and that kind of things.

Now, page 23 now, about the funding; we have worked, significantly, with the long term funding for ourselves and the beginning of this quarter, just the beginning of April, we received - issued Eurobond and received 300 million from that issue. The issue went well and happy to report that bonds also have traded well, so all those who participated in that trade, I think, are quite happy now and hopefully stay happy until the maturity of the bond. Secondly, what is, I think, very important to us and also definitely important to our creditors is that our equity has been increased by EUR150 million. Basically, the general meeting decision was done in May, in June sorry, and then in 10th of July, basically, it was paid in cash to ourselves. So, I think that definitely a comfortable - made us more comfortable and then should make all our creditors more comfortable as we are now much more comfortably carrying on with those investments that we have committed to. On the debt metrics side, I think the metric is still very reasonable. The net debt to EBITDA is 2.1 currently, as we have communicated our covenant is on the level of three. The ceiling three so we do not expect to reach 3.0 on net debt to EBITDA and hopefully stays somewhat below that ceiling. But going in the nearest future, we will probably see at least some increase in this debt gearing but hopefully probably not much.

Now, coming to outlook for this year – page 24 – we have changed the outlook a bit from last quarter. During last quarter we saw or showed that our revenues would increase slightly. Currently, when we see where the electricity prices are we most likely see that revenues will be stable. We have downgraded a bit our outlook in revenues, but nevertheless we have a bit increased our outlook in the profitability side. And last time we showed last - slight growth in the EBIT and then now it seems to be, and we expect, a more solid growth in the EBIT side. The main reasons being that the lower margins are good, CO2 prices are lower; our margins in the power market are good and on the mining side, as well. The CO2 plant looks good and therefore, we do see that also looking at what we have achieved during the first half year of this year; then altogether this should come out pretty good. Now, to summarise, we had lower revenues, but nevertheless higher profitability and also higher cash flows that we are very happy of. EBITDA grew 15 percent and EBIT 13 percent during the last quarter. If we look at the main reasons behind the profitability growth then it was higher profitability in the distribution network and also electricity sales were more profitable, and the negative effect came from those non-recurring items. That makes that result even stronger, I would say. Investments were EUR95 million, we do carry on the investment plan as planned currently. Also on the financing front we had two transactions done on the long-term financing side, the Eurobond and equity injection from the Government and that does give a very secure footing to our financing of this investment plan.

So, thank you from my end. If anyone has any questions, then definitely I am happy to answer them and clarify things further if something was not so well explained. Thank you.

Operator:

We will now begin the question and answer session. Anyone who wish to ask a question may press star and one

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on their touchtone telephone. If you wish to remove yourself from the question queue, you may press star and two. Participants are requested to use only handsets when asking a question. Anyone who has a question may press star and one at this time. We are waiting a moment for questions.

(break)

There is one question comes from Tapio Jokisaari of Pohjola Asset Management. Please go ahead, Sir.

Tapio Jokisaari: Yes, hello. I would like to ask about your revenue outlook which you have downgraded due to lower electricity prices. So, could you comment on what kind of electricity prices are you expecting to see towards the end of the year in the Estonian market and also if you can comment on the outlook going forward

Margus Kaasik: Well, if you look at the electricity market here in Estonia and then prices, what we see now on the power exchanges, are roughly, on average about EUR30 per MWh. On the retail market they are somewhat stronger, more like EUR40 per MWh, currently. Going further and going ahead: what we see that we do not expect too much recovery in the price, in the wholesale or power exchange prices during the next quarter, the Q3. By the end of the year, although, we would see that the prices should come back to the level of 42 to EUR50 per MWh; that was the spot prices I was talking about. So, we were expecting a bit higher prices for the second - for the whole year and also for the second half of this year, but the changes are not that significant, but they do command that we downgrade a bit the outlook of our revenues.

Tapio Jokisaari: And do you use any hedging?

Margus Kaasik: Of course we do. Of course we hedge our revenues. Most, or a big part of the revenues for 2012, of the current year is hedged and was hedged definitely, but there is still some part of the sale that is open to prices, but a significant part of the price in 2012 is hedged definitely.

Tapio Jokisaari: And 2013: have you hedged any of those prices yet?

Margus Kaasik: We have. We have and if we look at the 13, and very roughly, we have hedged about 30 percent of the power generation that we have. Our target, by the end of the year, is to reach, somewhere, 80 to 90 percent. What reduces the hedges for next year is that we do not have any regulated market - that is, basically, the fixed price market. From next year on the market will be open, but then again the market opens in one bang from 1st of January next year and those people are not - well, those people are not reachable yet. So, we can use retail markets to a limited extent, currently only; and also in the financial markets we have limited amounts that, only, we can basically hedge the sale that we, basically, do to Helsinki, Finland area; not for Finland area, and move those forward in an upward market. In the Estonian market we do not have any forward so we have limited possibility to the financial market, but nevertheless given those constraints I think what we have achieved during the first half of this year to hedge about 30 percent of our next year sales is quite good and the amounts for '14 are actually quite similar already. So, both '13 and '14 are somewhat hedged and the hedged figures we will start to go up quite fast when we reach the end of the year and when the - all this new retail market in Estonia is available to us.

Tapio Jokisaari: Okay and if I can just - one add-on question is how did the regulated, in Estonia - how is it that pricing where the free market price is looking to be, if you can comment on that?

Margus Kaasik: Basically, well the regulated price for electricity is roughly EUR30 per MWh. On open markets we see prices more like EUR40 and thereabout, so there is some difference. Much of this difference is actually eroded by CO2 costs as, basically, we had pre-allocation for these regulated sales. So basically, that was so-called CO2-free price for those customers that we are serving on the markets. They will also carry the cost of CO2. So, that takes a large part of the difference away from it. Well, we currently still have the CO2 price now very small, or very low. We see that the electricity margin, probably, increases slightly next year but then again - it is really tough to see what actually are the forward prices closer to the end of this year; what customers would choose: whether they go for fixed prices contracts based on forwards, whether they go for spot prices, what the spot prices are and so. I think, on average we do not expect too much to gain from that market opening, currently; as the current market prices are quite depressed actually.

Tapio Jokisaari: Yes, okay, thank you.

Operator: Ladies and gentlemen, please press star and one for your questions.

(break)

Gentlemen, there are no further questions, at this time.

Margus Kaasik: Well, if there are no further questions, then I thank everybody for participating in this call and in the next three months we have another call and, definitely, happy to see you around, also, next time. Thank you.