

Latvenergo Group Unaudited Results of 2018

Investor Conference Webinar Presentation

6 March 2019

Transcript

Moderator: Ladies and Gentlemen, good afternoon! Welcome to Latvenergo Investor Conference webinar about financial results of the year 2018. Today we are hosted by Latvenergo Chief Financial Officer Guntars Baļčūns.

As always, we will start the webinar with a presentation after which we will hold a questions and answers session. Please feel free to use the questions box in the webinar admin panel to type in your questions to the company.

Mr. Baļčūns, I invite you to start the presentation!

Guntars Baļčūns: Dear investors, dear stakeholders, good afternoon. My name is Guntars Baļčūns and I'm the CFO of Latvenergo. It's a pleasure to welcome you to our regular webinar, presenting Latvenergo Group's results for the year 2018.

Latvenergo Group Profile [slide 4]

As usual, I'll start the presentation with a short introduction to the Group.

Latvenergo is a vertically integrated utility that operates in all three Baltic countries. It is wholly owned by the Republic of Latvia. Moody's credit rating for Latvenergo AS has been stable for several years and it is at the Baa2 level with a stable future outlook.

Our energy generation portfolio consists of hydropower plants (HPPs) and highly efficient combined heat and power plants (CHPPs). We are one of the leading energy suppliers in the Baltics and one of the most environmentally friendly electricity producers in the European Union.

Regarding changes in corporate governance, I would like to mention that in 2018, the Supervisory Board of Latvenergo AS established the Strategic Communication Committee to ensure the supervisory functions within the scope of the strategic communication. The Committee is composed of the Members of the Supervisory Board.

Market Overview [slide 6]

The year 2018 was challenging, so let me first highlight some of the key market factors and events that affected our business performance.

In 2018, the Nord Pool region experienced a significant increase in electricity prices. Electricity prices increased due to warm and dry weather in Europe, lower water levels at Scandinavian hydropower reservoirs, lower output of wind energy, and higher prices of energy resources and CO₂. Electricity prices in the region increased by more than 40% compared to 2017. In 2018, the average electricity price in Latvia rose to 49.89 euros per MWh, which is an increase of 44%.

Along with this increase, Latvenergo's role in the electricity market grew. In response to the market situation, we've increased the output of electricity at our CHPPs by 87%. Our reconstructed CHPP-2 is one of the most efficient and up-to-date combined cycle power plants in the Baltics and therefore we were able to increase the CHPPs' electricity output even at higher gas and CO2 emission allowance prices.

In 2018, the natural gas prices at the Gaspool and TTF trading platforms were on average 30% higher than the year before.

Revenue and Profitability [slide 7]

Now let's turn to the 2018 financial results for Latvenergo Group.

The warm and dry weather in Europe, higher energy resource and CO2 prices and changes in tax legislation negatively affected the Group's financial results.

In 2018, Latvenergo Group's revenue was 878 million euros, which is 5% less compared to the previous year. Meanwhile, EBITDA decreased by 41%, reaching 321.6 million euros. The significant change in the Group's EBITDA is accounted for by the previous year's decision of Latvenergo AS to apply for a one-off compensation from the state in the amount of 454 million euro, at the same time opting out of the receipt of 75% of the annual electrical capacity payments for cogeneration power plants. In 2018, lower support intensity for Latvenergo AS CHPPs and lower CHPPs' compensation recognised in revenues resulted in a negative impact totalling 122.0 million EUR on the Group's EBITDA. The Latvenergo AS CHPPs' support buy-back has contributed to reduction of the mandatory procurement fee by 15%, and at the moment the average fee is 22.68 euros per MWh. The remaining part of the decrease in the Group's EBITDA in amount of 104 million EUR is attributable to the 1.9 TWh lower electricity generation at the Daugava HPPs and higher electricity prices in the Nord Pool region.

The Group's profit amounted to 76.0 million euro. In addition to the above-mentioned factors, the Group's profit was negatively affected by changes in corporate income taxation. In 2017, deferred tax liabilities in the amount of 149.1 million euros were reversed as a result of the corporate income tax reform, and this improved the results for 2017.

Generation and Trade [slide 8]

And now, let's continue with a more detailed review of each segment.

Generation and trade is the largest segment, making up 46% of the Group's EBITDA. The results were negatively impacted by the same factors as the *Latvenergo* Group results overall.

In 2018, the electricity generated at Latvenergo Group's power plants decreased by 11% and comprised around 5 TWh, from which 2.4 TWh was generated at the Daugava HPPs and – 2.6 TWh at the combined heat and power plants. It was historically the largest amount of electricity generated at CHPPs. Such an increase in electricity generated at CHPPs was determined by the rapid rise in electricity prices in the region, which increased by more than 40%. In such market conditions our CHPPs played a significant role in ensuring electricity demand. The role of the Latvenergo AS CHPPs was particularly important at the time when there were limited electricity supply possibilities and the electricity price was the highest. In total 1.5 TWh of electricity were generated in cogeneration mode and 1.1 TWh – in condensation mode.

However, electricity generated at the Daugava HPPs in 2018 decreased by 44%. This was impacted by almost twice lower water inflow in the Daugava River. It is worth remembering that 2017 was historically one of the most successful years for us regarding hydropower output.

In 2018, we sold 7 TWh of electricity to customers in the Baltics. 1/3 of this was sold to customers outside Latvia. The total number of customers outside Latvia now reaches more than 35 thousand.

In addition to electricity sales, in 2018 under the *Elektrum* brand we started gas sales to business customers in Lithuania. The total number of gas customers in all three Baltic countries already exceeds 400. *Latvenergo* now successfully operates in the electricity and gas segments in Latvia, Lithuania and Estonia.

We also are pleased that more and more customers are showing interest in other products that we offer, such as *Elektrum Solar* and *Elektrum Insured*. In 2018, we installed solar panels for 70 customers in the Baltics with a total capacity of 370 kWh and launched trade of *Elektrum Solar* in Estonia as well. Also, the number of *Elektrum Insured* customers continued to increase, reaching more than 41,000 at the end of the reporting year.

The range of new products and services that *Latvenergo* offers to customers is increasing from year to year and as of February 2019 we have additional new products. I will tell you more about that a little later in this presentation.

Distribution and Transmission [slide 9]

Moving on to slide 9, let's take a look at the performance of the distribution and transmission segments. Both segments cover fully regulated businesses that are operated by *Sadales tīkls AS* and *Latvijas elektriskie tīkli AS*. Together they make up half of the Group's EBITDA.

In 2018, the distribution segment's revenue remained at the same level as the year before, reaching 323 million euro. Meanwhile EBITDA increased by 7%, reaching 120 million euro. The results were positively impacted mainly by the efficiency programme, which was launched in 2017. Within the framework of this programme, we are planning to reduce the number of employees at *Sadales tīkls AS* by around 800 by 2022. By the end of 2018, the number of employees at *Sadales tīkls AS* was already reduced by 500 employees.

The segment's results were also positively impacted by the increase in distributed electricity of 2%. However, higher electricity prices contributed to an increase in the cost of distribution losses.

We have successfully continued our smart meter programme and so far we have already installed almost 550 thousand smart meters. This means that at the moment half of the electricity meters of *Sadales tīkls AS* are already smart meters and they count 83% of the total electricity consumed by customers.

The transmission segment makes up 13% of the Group's EBITDA. In terms of financial performance, this segment's revenues and EBITDA have decreased slightly. The decrease is related to the lower cost of the capital rate set by the Regulator.

In 2018, investments increased by 38% compared to the previous year, reaching 87.1 million euro of which 65 million euro was invested in the *Kurzeme Ring* project.

Investments [slide 10]

On slide 10 we've summarised our investment figures. Capital expenditures have decreased by 10% compared to 2017, reaching 220.6 million euro. Approximately 80% of investments are made in the distribution and transmission segments.

In 2018, the largest investments were made in the *Kurzeme Ring* project. This is an energy infrastructure project aimed at the reconstruction of a transmission network in the western part of Latvia. In 2018, 30% of the Group's total investments were invested in this project. It is scheduled for completion by 2019, and the total planned project costs are approximately 230 million euro with around half of the costs financed by EU funding.

Meanwhile, the *Daugava HPPs* reconstruction programme involves reconstruction of 11 hydropower units. So far, we've invested 149.5 million euro in this project and 4 reconstructed

hydropower units have been put into operation within the programme. 3 of them were put in operation in 2018.

Funding [slide 11]

Let's turn to the funding part on slide 11. At the end of 2018, Latvenergo attracted loans from several commercial banks for a total amount of 240 million euro with a repayment term of 7 and 10 years. Total borrowings at the end of 2018 were 814 million euro, of which 17% were bonds. As you can see in the graphs on the left, Latvenergo Group has a very balanced debt repayment schedule and diversified sources of financing.

In the first quarter of 2018 Moody's reconfirmed the credit rating of Latvenergo AS, which remains Baa2 with a stable outlook. In June Moody's also affirmed the assessment of Latvenergo AS green bonds as excellent (GB1), indicating the well-defined organizational structure and decision-making process for selecting eligible projects.

In 2018, all the financial covenants set in Latvenergo Group loan agreements were met, and liquidity reserves were sufficient to implement the planned investment programme, fulfil the commitments according to the debt repayment schedule, and pay out dividends.

Current Events – Elektrum enters the Latvian household gas market [slide 13]

Now let's turn to current events. As you can see in this slide we have summarised all *Elektrum* products and services that are offered to our customers in the Baltics. One of the goals set in the Latvenergo AS strategy is to diversify product offerings and revenue streams. As I mentioned before, we have a novelty in our product range. In February 2019, under the *Elektrum* brand, *Latvenergo* launched natural gas trade to households in Latvia.

We had a successful entry in the business customer segment of the gas market – already 400 companies buy gas from *Elektrum*. This encouraged us to grow also in the household gas market segment. In total there are around 420 thousand households that consume approximately 1.4 TWh of gas.

We offer 3 different natural gas products to our customers. The products are developed by analysing the customer needs, namely, by looking whether the gas is used only for cooking in the kitchen or for heating as well. We believe, that the gas customers will be satisfied with our products as well as with our customer service and digital customer channels, which has been developing for years in serving electricity customers.

Highlights of 2018 [slide 14]

Before we start with the question and answer session, I would like to highlight the most significant events and summarise the financial results for 2018.

We took advantage of the increased electricity prices in the region and generated historically the largest electricity output at the CHPPs – 2.6 TWh.

Our investments in the distribution segment promote the quality and security of the energy supply. In 2018, the System Average Interruption Frequency Index (SAIFI) decreased by 11% and the System Average Interruption Duration Index (SAIDI) decreased by 13%.

As of 2018, *Elektrum* offers 100% digital customer service and Sadales tīkls AS is also nearing this goal. At the end of 2018 smart meters count 83% of the total electricity consumed by customers.

In May 2018, *Latvenergo* organised *FIZMIX Experiment*, the first ever physics festival in Latvia. This event was created for the popularization of physics and to encourage more and more young people to study exact sciences.

This June, Latvenergo AS received the Platinum category of the Sustainability Index and the highest overall assessment – 97.2%. This assessment affirms the sustainability of Latvenergo Group and its excellent corporate governance.

Latvenergo contributed to reducing the mandatory procurement fee on average by 15%, compared to 2017, thus strengthening the competitiveness of Latvian enterprises.

In 2018, for the tenth year in a row Latvenergo AS maintained the first place in the Latvia's Most Valuable Enterprises ranking, created by Prudentia and Nasdaq Riga. On the Baltic level, we are among the top three.

Overall, I'm satisfied with the Group's results, taking into account the unfavourable market situation, lower water inflow in the Daugava River and changes in the support intensity for the CHPPs. The Group's EBITDA in 2018 was 322 million euro and its profit amounted to 76 million euro. This provided a 2.9% return on equity.

That's all I have for now. Let's now proceed to the question and answer session.

Moderator: Thank you for the presentation. Let's proceed with the questions, that we have received from the audience now. Small reminder from my side – participants, you are welcome to ask your questions, if you have any, please type them in the “questions” section in the settings panel zone.

So, the first question we have received is the following - *Enefit* has entered Latvian household electricity market. Do you forecast them taking away part of your market share? If yes, how much?

Guntars Baļčūns: Thank you for the question. We see *Enefit* as a respected market player in the Baltic region and we generally look positively on the increasing competition in the Latvian household electricity market. This brings a long term benefit for customers and also market players. Our current standing in Latvian household electricity market is quite strong and we have also accumulated solid experience in the mass market segments in other Baltic countries. Of course, we understand that *Enefit* may gain a certain portion of the household electricity customers in Latvia, but we don't think it will significantly change our market position in the mid-term.

Moderator: Thank you. Our next question – do you plan any new bond issues?

Guntars Baļčūns: Thank you for the question. I would like to remind you, that recently we have attracted loans from commercial banks in the amount of 240 million euros, but new bond issue is in our plans in coming years. We will definitely do that.

Moderator: Thank you. It seems that the presentation has already provided many answers to participant potential questions since other questions have not been received. I'll remind you that the recording of the webinar will be available in the Nasdaq Baltic youtube channel and also in Latvenergo's announcements later today or tomorrow.

I'll take a chance and thank Mr.Baļčūns for presentation and participants - thank you for joining!

Guntars Baļčūns: Thank you! Good-buy!

