


# Latvenergo Group Unaudited Results 2019

Investor Conference Webinar Presentation

5 March 2020

Transcript



**Moderator:** Good afternoon Ladies and Gentlemen! It's my pleasure to welcome you to Latvenergo Investor Conference webinar. Today with us we have Latvenergo CFO Guntars Baļčūns.

As always, we will start the webinar with a company's presentation which will be followed by questions and answers session. You are kindly invited to participate by typing in your question in the questions box, which can be found in the settings panel zone.

Mr. Baļčūns, the floor is now all yours!

**Guntars Baļčūns:** Good afternoon everyone! It is a great pleasure to meet you again at the *Latvenergo* webinar to discuss the results of 2019. My name is Guntars Baļčūns, and I am the CFO of Latvenergo AS.

Again, any questions you may have during the presentation will be answered after the presentation.

## ***Latvenergo Group Profile***

As usual, a short introduction to the Group.

*Latvenergo* is a vertically integrated company that operates in all three Baltic countries. Latvenergo Group is comprised of the parent company Latvenergo AS and seven subsidiaries. However, I would like to inform you that on 8 October 2019 the Cabinet of Ministers of the Republic of Latvia decided to implement full ownership unbundling model until 1 July 2020. The implementation of full ownership unbundling model is planned through the reduction of the capital of Latvenergo AS by withdrawing the capital shares of Latvijas elektriskie tīkli AS. Therefore, the results of the transmission segment are reported as discontinuing operations.

*Latvenergo* is wholly owned by the Republic of Latvia. Latvenergo AS credit rating assigned by *Moody's* has been stable since 2015 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.

Before I start presenting the financial results of Latvenergo in detail, let me first highlight the key market factors and events that affected our business performance in 2019.

## ***Market overview***

In 2019, electricity prices in the Nordics and the Baltics were lower compared to the previous year. The main factors influencing the electricity price level were better hydrological conditions in the Nordics, by 19% larger output of wind generation, lower electricity demand in Scandinavia (mainly due to warmer weather conditions) and lower price of gas and coal. The electricity spot

price in Latvia was 7% lower than the previous year and was 46.28 EUR per MWh. However, in Sweden S4 electricity price was by 14% lower.

As we see in the graph, there was a quite large price spread between Baltic and Sweden S4 in 2019. The price spread increase was affected by lower electricity generation in the Baltics, especially in Estonia. Electricity output at oil shale plants in Estonia fell significantly due to high emission allowance prices.

In 2019, there has been a significant decline in the price of natural gas. In 2019, LNG gas import in Europe was historically highest – it increased by 70%. As well due to the relatively warm and short winter gas reserves in Europe has increased. In 2019, the natural gas prices at the GASPOOL and TTF trading platforms were on average 34% lower than the previous year. Such market situation was favorable to us, given that natural gas is used as fuel in the Latvenergo AS CHPPs.

### ***Revenue and Profitability***

And now, let's continue with the financial results of Latvenergo Group for the 2019. The Group's revenue in 2019 was just 3 MEUR more than in the previous year and it was almost 842 MEUR. Meanwhile, the Groups profit increased by 24%, reaching more than 94 MEUR. Latvenergo Group's EBITDA decreased by 14% to 244 MEUR. The decrease in EBITDA was negatively impacted by lower electricity output at Daugaves HPPs, as well as by lower CHPPs' capacity payments. However, the higher sales price of electricity had a positive impact on Latvenergo financial results in 2019.

### ***Generation and Trade***

Let's take a closer look at each segment. Generation and trade is the largest segment by revenue. It makes up 36% of the Group's EBITDA. It comprises electricity and thermal energy generation, electricity and natural gas trade in the Baltics and also administration of mandatory procurement in Latvia.

As well, generation and trade segment's results were impacted by 14% lower electricity output at the Daugava HPPs as you see in the graph.

However, in response to the market situation, we increased the volume of electricity generated at CHPPs by 5% and for the second year in a row, Latvenergo AS CHPPs had record-high electricity generation, reaching 2.8 TWh in 2019. In such market conditions in the Baltics, when there are limited electricity generation capacities, our combined heat and power plants played a significant role to meet the demand of the electricity market.

In 2019, the electricity generated at Latvenergo Group's plants decreased by 4% and was 4.9 TWh, from that 2.0 TWh was generated at the Daugava HPPs and – 2.8 TWh at the combined heat and power plants.

Due to warmer weather conditions during the heating season and competition our thermal energy generation decreased by 19% in 2019.

Last year we sold 6.5 TWh of electricity to customers in the Baltic countries. *Elektrum* products are chosen by more and more customers outside Latvia and approximately 1/3 of total retailed electricity was supplied to customers in Lithuania and Estonia.

In terms of diversification of our product offering and revenue streams, during the 2019, we successfully continued operations on the natural gas market, and the retail sales volume doubled compared to the previous year, reaching 303 GWh.

The number of solar panel contracts reached more than 320 with substantial growth in Lithuania. In 2019, our market share in the Baltics was approximately 8%. Also, the number of *Elektrum Insured* customers continued to increase, reaching almost 66 thousand customers at the end of the 2019.

Since launching *Elektrum* e-shop, turnover in *Elektrum* e-shop has continued to grow, providing more than 2,200 units sold.

In August, we started working in the electrical mobility market by launching the first fast electric vehicle charging stations. By the end of 2019, approximately 1,450 charges had been made providing assurance of further growth of the electric vehicle charging service.

That's shortly about our new products.

### ***Distribution***

Let's continue with the distribution segment. This segment provides electricity distribution services in Latvia. Sadales tīkls AS is the largest state distribution system operator, covering approximately 99% of the territory of Latvia. This segment is regulated, and distribution system tariffs are approved by the Public Utilities Commission.

In 2019, the distribution segment is Latvenergo Group's largest segment by EBITDA and asset value and the second largest segment by revenue. It makes up 45% of the Group's EBITDA. In 2019, there was a slight decrease in distributed electricity, which was mainly caused by the weather conditions and higher average air temperature. The segment's revenue decreased by 1%, reaching almost 320 MEUR. Meanwhile EBITDA increased by 4%, reaching 125 MEUR. In 2019, investments in distribution remained at the same level as a year earlier and was 95.1 MEUR. The distribution segment's asset value was almost 1.7 billion EUR at the end of the 2019.

The results were positively impacted by 18% lower distribution losses and by performed activities within the Group's efficiency programme which was launched in 2017. The efficiency programme includes digitalization, process reviews, installation of smart meters, decrease of transportation units, and optimization of the number of workplace and also optimization of real estate support bases. Considering the expected cost reduction from the efficiency programme, as of January 1, 2020, the average distribution service tariff was reduced by 5.5%.

### ***Lease of Transmission System Assets***

And now let's take a look at the Transmission segment. This segment conducts the lease of transmission system assets to the transmission system operator. As I already mentioned, it is planned through the reduction of the capital of Latvenergo AS to withdraw the capital shares of Latvijas elektriskie tīkli AS. Therefore, the results of the transmission segment are reported as discontinuing operations.

At the end of 2019, the transmission segment makes up 14% of the Group's EBITDA. In terms of financial performance, this segment's revenue and EBITDA did not change significantly. Revenue amounted to 40.0 MEUR and EBITDA was 39.8 MEUR. In 2019, investments in this segment reached 87.4 MEUR, which is approximately the same amount as in 2018. The largest investment was made in *The third power transmission interconnection between Estonia and Latvia* and also investments in *Kurzeme Ring*.

### ***Investments***

In this slide we have summarized our investment figures. Our capital expenditures increased by 9 MEUR compared to the 2018, reaching 229 MEUR. 87 MEUR were invested in transmission system assets and approximately 79% of all our investments were made in the power network assets.

Here you can see the main investment projects in progress.

Transmission investment project *Kurzeme Ring* has been completed and the total project construction costs are 225 MEUR. However, *transmission interconnection project between Estonia and Latvia* is scheduled for completion by 2020. Both transmission projects are partly co-financed also by the European Union's funding and congestion management revenues.

Meanwhile, the Daugava HPPs reconstruction programme involves reconstruction of 11 hydropower units. So far, we've invested more than 160 MEUR in this project and 5 reconstructed hydropower units have been put into operation within the programme.

### ***Funding***

Let's turn to the funding part. Total borrowings as of the end of 2019 reach almost 883 MEUR comprising loans from commercial banks, international investment banks, and bonds representing 15% of total debt. Here I would like to draw your attention to the fact that in connection with unbundling of transmission system assets, Latvenergo Group borrowings will decrease over time, as a loan in the amount of 196 MEUR will be repaid by transmission system operator. I will go into more detail about this in the next section.

On 9 October last year the shareholder meeting of Latvenergo AS approved a new bond programme in nominal value of up to 200 MEUR. The decision was based on the successful previous experience of issuance of the bonds and the opportunity provided by the capital markets to continue the successful diversification of financing sources on favorable terms.

At the end of the year, Latvenergo also attracted a loan of 100 MEUR from a foreign investment bank to finance investment projects.

On 15 October last year, the international credit rating agency Moody's affirmed the credit rating of Latvenergo at investment grade Baa2 with a stable outlook. Moody's credit rating for Latvenergo has been stable for five years in a row.

As you can see in this graph, Latvenergo Group has a very balanced debt repayment schedule.

During the reporting period all the financial covenants set in Latvenergo Group borrowing documentation were met, and liquidity reserves were sufficient to implement the planned investment programme and fulfil the commitments according to the debt repayment schedule.

### ***Current Events***

Now let's turn to current events. The EU Directive stipulates that electricity transmission system operator (TSO) should be unbundled from the companies operating in generation and trade. The EU has defined three types of unbundling models.

In 2011, an independent system operator model was introduced in Latvia, as a result of which Latvenergo invested its electricity transmission system assets in Latvijas elektriskie tīkli AS (LET).

LET is a subsidiary of Latvenergo AS, which leases these assets to the transmission system operator Augstsprieguma tīkls AS.

Taking into account that such a model of unbundling of transmission assets is one of the most uncommon in Europe, on 8 October last year, the Cabinet of Ministers passed a decision to support full unbundling of ownership of the electricity TSO. The model should be implemented till 1 July this year.

The decision practically means that transmission assets should be transferred from Latvenergo AS to Augstsprieguma tīkls AS.

The change of ownership of transmission assets is planned through the reduction of the capital of Latvenergo AS by withdrawing the capital shares of LET. After that, these assets will be invested in the share capital of Augstsprieguma tīkls AS, that is also state-owned company.

Decision of the Cabinet of Ministers also implies that the share capital of Latvenergo AS will be increased by its retained earnings, but not more than the market value of LET.

The market value of LET shares will be assessed by KPMG Baltics AS. As of the end of 2019, the book value of LET equity is 234 MEUR, but borrowings - 196 MEUR, which LET will repay to Latvenergo AS, when becoming a subsidiary of AST.

In this slide you can see the impact on financial situation as a result of unbundling of transmission system assets. As we saw in the group profile slide of this presentation transmission segment contribute 4% of revenue and 14% of EBITDA. Equity value of LET is 234 MEUR, that corresponds to about of 10% of Latvenergo group equity.

We have estimated indicative impact on capital structure ratios of the Latvenergo Group. Here I would like to note, that in calculation of net debt the discontinuing operations related to unbundling process are excluded. After the unbundling process capital structure ratios still would remain better than industry average. Net debt/equity ratio would increase from 25% to 28%. Industry average - 50%. As well as reasonable headroom in financial covenants would remain.

In addition, as mentioned before, LET will repay loans received from Latvenergo AS, when becoming a subsidiary of AST, which would result in a decrease in the amount of Latvenergo Group borrowings over time, as well as it will result in lower level of investments. In 2019, 87 MEUR were invested in transmission system assets.

Additionally, I would like to emphasize, that Moody's considered the planned unbundling of transmission system asset ownership, when affirming the credit rating of Latvenergo AS at the current level.

This is shortly about transmission system unbundling.  
I would like to summarize my presentation.

### *Summary*

In order to meet market demand, the electricity generated at the CHPPs reached 2.8 TWh which is historically the highest electricity output.

In 2019, we supplied 6.5 TWh of electricity and 303 GWh of natural gas to retail customers in the Baltics. That is two times more than in the last year.

In 2019, the total amount of investment was 229 MEUR, largest part of that is invested in distribution and transmission assets.

Overall, I'm very satisfied with the Group's results. The Group's EBITDA in 2019 was 244 MEUR and profit - 94 MEUR. Profit in 2019 is up by 24%.

Thank you for listening and now let's proceed to the question and answer session.

#### **Moderator:**

Thank you for the presentation. Participants, before we start, if any of you have a follow-up question on the presentation or any other topic that you would like direct to Latvenergo, please feel free to do that by typing a question in the questions box that you see in the settings panel

zone. Meanwhile we are continuing with three questions that we have received in advance before the webinar.

So, the first one goes the following - *do you see the electrical vehical & solar panel trend to evolve over time? Do you expect it to contribute to Latvenergo revenue?*

**Guntars Baļčūns:** Thank you for the question. We think that both market segments are expected to grow in the future and to contribute to revenues of retail business. At the moment solar panel market is growing in all 3 countries and I would say very fast. The interest from customers is pretty high and we expect it will be even higher, especially in Lithuania where support program for solar panel installation is implemented.

Regarding e-charging it is expected to grow synergetic with growing number of e-vehicles in the market. Taking into account forecasts and international trends, it is forecasted that electric cars in Latvia could reach 36 000 already by 2030. But let's see. Any way, we see early presence in e-charging business as a precondition for being well recognized by customers in the market. We consider this business as a business with growth opportunity.

**Moderator:** Thank you. The second question that we have received – *what is the most important strategic focus for 2020? What are the biggest challenges that you see?*

**Guntars Baļčūns:** Thank you for this question. One of the key strategic focus is to strengthen our market position in Baltics that is mainly done by diversifying our product portfolio. One of the top priorities here is to be active in solar panels market in all three Baltic countries. Besides that, we are also willing to enter in electricity household market in Lithuania. Opening of electricity household market in Lithuania expected from January 2021.

However, in long-run Latvenergo will be facing the same challenges as most of energy sector companies in Europe, that is – keeping track to implement Green Deal initiative and to achieve zero emission targets by 2050. We as a member of Eurelectric are discussing these future developments and seeking for opportunities, to be ready to adjust our plans and strategy accordingly.

**Moderator:** Thank you. The third question that we have received is about CHPPs - *will CHPPs receive further support? How will they be affected by changes in the law?*

**Guntars Baļčūns:** Thank you also for this question. Draft amendments to the Electricity Market Law were submitted for review in the Parliament, the main idea of which was cancellation of the mandatory procurement component payment for end consumers of electricity.

It shall be noted that according to unaudited financial results of 2019 the profit of Latvenergo Group is 94 MEUR, while the annual compensation for both Latvenergo CHPPs capacity is 24 MEUR or approximately 15% of total mandatory procurement costs for 2019.

Here I would like to emphasize, that in 2017 Latvenergo already promoted a reduction of the mandatory procurement component for consumers by ceasing to receive 75% of annual electric capacity payments through support buyback procedure. Now the support for CHPPs is not the largest part of mandatory procurement costs, while at the same time Latvenergo CHPPs play critical role in stabilizing electricity price in the region and enhancing energy security. We believe, that this role will be increased in line with increase of wind generation in region and expected synchronization of Baltic transmission systems with European electricity networks from 2025. We really see that CHPPs have important role in electricity market in the Baltics and also in the region.

**Moderator:** Thank you. One more question came in. The question goes the following way – *can you please comment Latvian Prime Minister recent comment "if OIK subsidies are cancelled for Latvenergo, then company will go bankrupt."*

**Guntars Baļčūns:** Thank you for the question. I would like to note that the credit rating of Latvenergo Group, that is set by rating agency Moody's, is at investment grade. The credit rating mainly shows the credit risk of the company and I would like to say that investment grade credit rating shows, that investors should not be worried about the financial situation of Latvenergo Group.

**Moderator:** Thank you. Currently there are no other questions coming in, so I shortly will start to wrap up. We have recorded this webinar, so for those of you interested – the recording will soon be available in Latvenergo announcements and also on Nasdaq YouTube channel.

Participants, thank you for joining! Mr.Baļčūns, thank you for taking your time to guide us through Latvenergo most recent activities! See you in the next webinar!

**Guntars Baļčūns:** Thank you! Good-buy!

