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Q3 2019 Vattenfall AB Earnings Call

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**Henrik Borgström**

**Elchin Mammadov** *Bloomberg Intelligence - Analyst*

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**Andreas Zsiga** *Nordea - Analyst*

## PRESENTATION

**Karin Lepasoon** *Vattenfall AB - Head of Communications*

Good morning and welcome to this presentation of Vattenfall's nine-month report 2019. In a moment, we'll hear from our CEO, Magnus Hall, and our CFO, Anna Borg, and in the end we'll open up for questions. As usual, this is a live meeting here in Solna combined with a web and telephone conference. With that, Magnus, I leave it over to you.

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**Magnus Hall** *Vattenfall AB - Chief Executive Officer*

Thank you very much, Karin, and also from my side a warm welcome to everybody to this morning's meeting of the nine-month result for Vattenfall 2019 and to fire off, I think we are both developing strategically and financially in the right direction.

Financially, we can show an increase in the EBIT with SEK1.6 billion to SEK16.9 billion, mainly driven by higher prices for electricity, good wind speeds, which was also partially offset by negative effects of the storm Alfrida in the distribution business.

The profit for the period increased significantly with SEK5.5 billion to SEK14.4 billion, mainly driven by one-off items related to the divestment of the heat network in Hamburg and also the sale of nuclear production rights in Germany.

So that was the financial part. If you look from strategic, we can see several things that are pushing Vattenfall in the right direction. We won the bid for the offshore wind farm Hollandse Kust 3 and 4 in the Netherlands which we will then combine with Hollandse Kust 1 and 2 to make a good combination of the both. Totally 1.5 gigawatts of wind power being built outside the Netherlands.

The transfer of the heat business in Hamburg was concluded on the 2nd of September with SEK3.1 billion as a net gain. We also installed Europe's biggest power-to-heat facility in Berlin which was connected during the quarter and that enabled the closing of one coal-fired power plant. And Ringhals 2 has just started to be on reduced. We are reducing the power capacity in preparation for the closure to the end of the year.

And we have the name change of Nuon which we carried through during the year, but just after also the change of the quarter where we're changing from Nuon to Vattenfall and it's been very successful so far.

On the last point that we have, and I will come back to that, the Energy Markets Inspectorate in Sweden have decided on a revenue framework for our distribution operations in Sweden. We will come back to that.

On this picture, you can see that we are showing positive gains on everything from sales to all the different lines of results. The underlying operating profit which is really showing the direction of the company has a healthy 11 percent, but of course the one-off gains shows that we have a 60 percent increase in the profit for the period which is then significant.

We can also see that we managed now for the rolling 12-month period to reach both the financial targets that the owner has set up for us, over 8 percent on return on capital employed which meant we delivered 9.2 percent and then an FFO to adjusted net debt where the target is between 22 percent and 27 percent, we reached 24.5 percent.

A little bit on the different business areas and we should start with Customers and Solutions, our retail sales business. We can see that we have higher sales in most markets, but we also have an underlying profit which is then suffering compared to last year from warm weather.

We have lower gas sales. We also have quite a few growth projects that haven't started to deliver yet and we do have higher purchasing costs for electricity which we haven't been able to offset in higher prices to our customers. That will come during the quarter.

But the customer base grew from 8.9 million to 9.4 million, so we continue to do that. We see mainly growth in Germany, but we also had an acquisition of the DELTA Energie in the Netherlands and as you can see to the right in this picture that we are continuing our investments into charging infrastructure for e-mobility where we can go from 9.1 thousand connection points for electrical vehicles to 13.7 thousand points at the end of this quarter.

Power Generation is our business for nuclear and hydro power production and also the services operation in Sweden. We can see there we had higher prices which meant that our result increased from 8.5 billion to 11.2 billion during the first nine months and of course it was due to higher achieved prices. We do run a hedging process which means that we are not following the spot price development that some people will see in the market and we had an increase versus last year.

We had some lower production mainly in the nuclear because we had a problem with Ringhals 2 due to a generator which we then replaced and it has been running now since before the summer and of course now we will start reducing the output, as I mentioned earlier, on the Ringhals 2 in preparation for the final decommissioning at the end of the year.

We can see that the development for the hydropower in Sweden is mainly related to the hydro balance. We can see that it's fairly balanced at the moment and if we look to future prices for electricity, we can see a difference that has been slightly growing in between Sweden and the continent, but the difference of course there remains for the future.

Wind, we can see a stronger result. That's of course an area where we are investing the lion's share of our growth capital. So we should see growth there driven by additional capacity, but we also had higher wind speeds during this quarter. We can see that we went from SEK1.9 billion to SEK2.5 billion in operating profit. We won the bid, as I mentioned, for Hollandse Kust 3 and 4.

So we have a healthy pipeline going forward in the wind business and you can see to the right of this picture here that we have increased our installed capacity to be roughly 14 percent compared to the same period last year and the production then increased from 5.3 to 6.7 terawatt-hours which is exactly in the right direction for what we want to see on the wind side.

Heat, good customer growth. We have a roadmap for phase-out of coal in Berlin. If you look to the underlying operating profit, it's roughly the same as last year even though you can see that the net sales increased slightly as a result of some positive price effects, but we haven't been able to get that through in increased profits.

A big part is also because, as you can see from the right side of this picture, that the spreads, which means that what you actually earn in between your costs and the market price for production of coal-based which is the clean dark spread we call it to the left, you can see that's quite negative in Germany. So the earning power of the the coal-based condensing is currently quite weak.

We transferred the district heating business. It's now out. I also mentioned that on the 2nd of September and we did this feasibility study together with the Berlin City where we are able to phase coal out by 2030 and following that, we are now then reinvesting in changes which means both closing coal power plants, but also replacing with other means of producing heat for our customers.

Distribution, we have there, of course, the main happening during the year was the storm Alfrida. That's still hampering our results. You can see that quite clearly here, that we have a lower result for the first nine months, roughly SEK1 billion compared to last year.

You can also see that what we call the key data service levels, the SAIDI, which means that in Sweden, you compare the 2018 figure to 2019, we've gone to 128 minutes to 423. Now, that's a little bit difficult to understand, but that's the significant difference actually related to the Alfrida storm.

You can also see to the right that we are continuing to increase our investments roughly by 7 percent so far this year and we have done so for several years and of course this is now then related also to the development that we will see where we have just received yesterday the framework, the revenue framework, for 2020 to 2023 and where we can see that we have a significant decrease versus the last period and of course we expect a rough EBIT impact of some SEK2 billion per annum.

Now, exactly how it will look in terms of price changes and how we will deal with this framework is something we're going to work out during the coming months. So there is not so much more to comment on that, but of course we are not very positive about this development.

As we all know, we need to invest much more in the distribution networks and also we need to invest much more in the transit - the high-voltage network and we can see that the Swedish transmission operator, is now increasing its investment quite considerably which also means a cost increase for our customers in the end.

But we have at the same time announced quite considerable increases in investments around Stockholm. We know that we need to safeguard also the regional networks and that we are going to put money as much as we can into this, but over time, we will have to revisit our investment plans and see how we can deal with this lower framework that we get.

So with that, I can conclude. We are definitely on our way both financially and strategically. It feels quite good and with that, I would like to leave the word to our CFO, Anna Borg, please.

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**Anna Borg Vattenfall AB - Chief Financial Officer**

Thank you, Magnus, and good morning. We are on the right way not only strategically, but also financially and let's take a look at the numbers for the first nine months.

We did increase our net sales with 12 percent. So it's now amounting to SEK120.2 billion. This is due to higher achieved prices which means a combination of the hedges we've made and also the non-hedged generation capacity that we're selling on the spot market. So the combination of these two are higher compared to the same period last year.

In addition, we see increased sales both in the Nordics, in Germany and in the Netherlands. Compared to the same period last year, we also see increased wind production. That is mainly because we simply have more wind farms up and spinning this year.

Our underlying EBIT is also increasing with SEK1.6 billion. That is mainly to our generation and wind business, but we also have some negative effects in here which are, for example, the costs for the Alfrida storm in the beginning of the year in Sweden which had an impact of almost SEK1 billion in extra cost for us.

On top of that, we can see that we have a slightly lower underlying EBIT in our Customers and Solutions business. That is due to growth activities, but also due to warm weather in the Netherlands.

Our profit is increasing with SEK5.5 billion compared to the same period last year and is now SEK14.4 billion. Here we have the two one-off effects as well, both the capital gain from the sale of the heat Hamburg business of SEK3.1 billion, but also the sale of nuclear production rights in Germany which renders SEK1.5 billion.

So we are reaching our return on capital employed target. It's now at 9.2 percent and the main contributors to that is then the gross margin in the generation and wind business, but the capital gain also have an impact. When it comes to FFO to adjusted net debt, we are now showing a result of 24.5 percent which is mainly due to the increased EBITDA in the business.

Taking a closer look at the development of the underlying EBIT, we can see in our Customers and Solutions business that we have growth activities ongoing. They are mainly taking place in our consumer business in Germany and there we also see a very short payback period on those investments, but in addition, we see lower sales, especially in the Netherlands, and that's mainly relating to gas sales due to the warmer weather which simply means that our B2C and B2B customers are using less gas for heating.

When it comes to the generation segment, we can see that these increased achieved prices, again the combination of hedges and open positions, are increasing. When it comes to our wind business, the main increase is coming from the added capacity, but we also see that we have stronger winds the first nine months this year compared to the same period last year.

In our heat business, we do see increased revenues compared to last year, but we also see increased costs. So the development is fairly flat year-to-year. In our distribution business, the negative impact you

see is solely from the storm Alfrida and the costs related to that.

Taking a look at the cash flow development, we can see an increased FFO compared to 2018. It's increasing with 7.4 billion. It's because of the increased EBITDA, but also due to lower taxes paid compared to last year.

The change in working capital or changes in working capital is due to margin calls, but also due to net receivables and liabilities in our heat business and in our Customers and Solutions business. That is due to the seasonality pattern that we always see and you have seen the opposite effect of that earlier in the year while quarter three and four are usually good quarters in that regard.

Then you can also see that we have made investments, both maintenance and replacement investments and growth investments which also have an impact here, which brings us to the total investments so far for the first nine months of SEK16.5 billion. Thirty-five percent of this is going into wind, solar and biomass, while 25 percent is going into our network operations.

The investments that you see on the right-hand table into fossil fuels is mainly conversions of existing coal-fired power plants or heat plants into other kind of fuels. The other category of investments, that is 17 percent here year-to-date, is due to the acquisition of the DELTA business in the Netherlands.

And then I would like to mention something shortly about our pension provisions because we did some additional provisions this quarter as well. That is due to interest rates being lower. So we have increased our provisions correspondingly with SEK3.8 billion.

And to summarize, we can see that we are going from net sales the same period last year of SEK107.1 billion up to SEK120.2 billion this year. Also the EBITDA is improving from SEK25.7 billion to SEK33.6 billion. And finally, the profit for the period is increasing quite steeply from SEK8.9 billion to SEK14.4 billion. This means that we now rolling 12 have a return on capital employed of 9.2 percent and an FFO to adjusted net debt rolling 12 of 24.5 percent.

That's above our target levels of 8 percent for return on capital employed and 22 percent to 27 percent of FFO to adjusted net debt. So we need to stay above those hurdle levels and that's also where we intend to be going forward. Thank you.

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## QUESTIONS AND ANSWERS

### **Karin Lepasoon *Vattenfall AB - Head of Communications***

Thank you, Anna and Magnus. It is time for the Q&A session and we start by asking if there are any questions from the audience here in Solna. Any questions here? Doesn't appear to be the case. Then I believe we have some questions on the web, Markus.

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### **Markus Friberg *Vattenfall AB - Communications***

Yes, we do. Already covered a bit in the presentation I think, but from Andrew Moulder of CreditSights

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### **Andrew Moulder *CreditSights - Analyst***

The drop in EBIT from distribution is significant. Have you identified any operational improvements you can make or any investments you can reduce or defer in order to mitigate this impact? Are there any

previous period recoveries you can use to offset the reduction? And what are your expectations net-net on the EBIT and cash flow reduction going forward?

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**Anna Borg Vattenfall AB - Chief Financial Officer**

Well, I think that if we start with the numbers this year, the decline is clearly connected to the storm Alfrida which was in the beginning of the year. That's approximately SEK1 billion, but I assume the question refers also to the regulatory situation going forward.

We are always looking for operational improvements in all parts of our businesses, but I wouldn't say that we have something in our distribution business that significantly deviates from normal business operations.

When it comes to investments, we're constantly reviewing that and now that we analyze the revenue frame that we received yesterday late, of course we will see what we can do when it comes to optimizing also investments going forward. The EBIT impact so far, which was also displayed in the material, is somewhere around SEK2 billion a year, but it's too early to say more in detail. We'll need to do the analysis first.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

But I think it's important to say, though, that the immediate effect on investments will not be to reduce it because we have started a lot of projects that we need to finish and we also have commitments which we have made. So over time, we will have to come back and reduce it, but it takes some time before we get that effect.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

Good. Let's continue on the web.

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**Markus Friberg Vattenfall AB - Communications**

Yes. Then there is a question from Henrik Borgström.

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**Henrik Borgström**

What would it cost to save Ringhals 2 when it comes to investments for prolonging the lifetime some years and how much would be possible to export from the production to Denmark and Germany with current networks?

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Well, I mean, first of all, we don't speculate on what it would cost to take Ringhals 2 back into long-term operation because we have considered that we can't see that the prices are covering those investments. So for us, it's a clear decision. We are going to close it.

If we take the question of exports, I think that's very much depending on the consumption, the weather patterns. A lot of things we can't really calculate on that, but today Sweden has an export surplus for electricity in general, but from time to time, we also import. So it's quite difficult to answer that question.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

All right. I believe we have a question on the telephone. Let's invite the next question from the telephone please.



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**Operator**

(Operator Instructions) The first question comes from the line of Elchin Mammadov from Bloomberg. Please go ahead.

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**Elchin Mammadov Bloomberg Intelligence - Analyst**

Hi there. Elchin Mammadov, Bloomberg Intelligence. I have three questions, please. The first one is could you please update what's the deal with your nuclear quotas transfer to Eon?

The second question is again on Swedish grid. Do I understand correctly that the EBIT impact, if I take the 2018 full-year number, is about a 30 percent reduction because of the new tariffs? And if so, is there any other legal recourse that you could pursue to challenge this or is that set in stone, the WACC, and what not?

And the final one is on the offshore wind. What are the key focus geographies for you? Is it still only Europe or are you prepared to look abroad? And if it's Europe, does it include Poland where a lot of your peers have entered recently or you're just focused on your existing key markets? Thanks a lot.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

Thank you very much. So three questions.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Yes. The production rights in Germany, I mean, the rationale behind the whole process is that we operate two nuclear power plants. We own them together with PreussenElektra which is E.ON and they have steel production rights that are available for us, but we can't use it for others to use. And then there are operators in the market who need more production rights to run their nuclear power plants up to 2022 which is then the finishing date for production of nuclear power in Germany.

And so there is a market for these because some people need more and yes, we have transferred some production rights. I don't want to go into the details, but for us it means SEK1.5 billion in terms of gains, extra gains, for this quarter actually. And yes, there would be a continued discussion around production rights and what the outcome will be, we will just have to see.

When it comes to the Swedish grid, yes, we expect an EBIT impact of SEK2 billion, but we will, of course, as far as we can, think through whether we should challenge certain things in this proposal.

We haven't taken that decision just yet and we just received our revenue framework yesterday. So we're fresh into this and so we will see, but the general discussion is of course the fact that we believe that 2.16 as a WACC is much too low and this discussion around that, we will have to see how we revert to that.

Yes. And offshore geographies, we see enough growth opportunities within European boundaries. So from our aspect, we're not planning anything outside Europe.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

There was a specific question on Poland also.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**



Yes. I mean, we are taking into consideration all European markets whether they are of interest to us and then when it comes to individual markets, when we come out with information on those, we will share that.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

Good. I believe there is one more question on the telephone. Please go ahead.

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**Operator**

The next question comes from the line of Jakob Magnussen, Danske Bank. Please go ahead.

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**Jakob Magnussen Danske Bank - Analyst**

Thank you very much. So assuming that you're not able to change this WACC decision of 2.16, when will we start to see a decline in investments? I realize you have a lot of committed investments in the short-term, but are we talking one, two years out in the future where your capex budget will be reduced compared to your original compensation?

And also, we're seeing a lot of stories of inadequate network and generation capacity, especially around the largest cities in Sweden. So how does that harmonize with the regulator incentivizing the industry to reduce capex towards networks? Can you talk a little bit about that, what the politicians are talking about in relation to this?

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**Anna Borg Vattenfall AB - Chief Financial Officer**

Yes.

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**Jakob Magnussen Danske Bank - Analyst**

Thanks.

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**Anna Borg Vattenfall AB - Chief Financial Officer**

So starting with the investments, we will not see an immediate impact. The problem we have is that a lot of the investments are also mandatory, so we need to analyze carefully what we can impact and when. There will be no substantial or major effect neither this year or next year, but long-term, of course, we have to see how we can prioritize.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Yes. When it comes to this question of networks around, yes, we do have a general discussion about transmission and distribution capacity in Sweden and I think we all agree that we need to improve it. We have several obstacles, not only the investments of course, but also the permissions. In order to build new lines, we need permissions and it takes much more time than you could ever think of.

So we need to attack this from two fronts. One is from the permission part to make that more efficient and the second part is then to get the investment money. We can see now that the Swedish transmission operator has just increased its tariffs with 24 percent, has announced that. So that's a considerable increase which we will then, of course, have to carry through to our customers.

Therefore, I hope that we will get some sort of a balanced long-term discussion on how we can actually provide an investment incentive for all involved parties and right now, of course, we have with this opinion on 2.16. That's really not driving the investment wheel and I think that's not good. So let's see. I hope that over time we will get this balanced discussion and then find a good long-term situation for the

way forward.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

All right. Good. I believe we have another couple of questions on the web.

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**Markus Friberg Vattenfall AB - Communications**

We do, on wind, also from Andrew Moulder of CreditSights. Can you comment on reports that Sweden might phase-out onshore wind subsidies by 2021? How do you see the Nordic offshore market developing in terms of subsidies? And lastly, have you decided yet on what turbines you will be using for Hollandse Kust Zuid 3 and 4 and is the FID taken?

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Yes. I mean, subsidies for wind onshore in Sweden it's not 100 percent clear, but they're talking about closing the system or actually allowing everybody to participate in the system which means that there will be almost no value of the certificates going forward and I think we can see that now. They are trading at very low prices. But the clear will is to phase them out.

When it comes to offshore wind power, there's an agreement that the connection should be paid by the transmission operator and not by the investor in the wind farm and so far we don't have any clear regulation around that. So we don't really know how to work, how they will distribute, where to build and sort of make the system as efficient as possible. There is a discussion around that now. We have some plans for where offshore wind should be, but are they in the right place to actually support the electricity system? We don't believe so.

So there's a continued discussion around that which will have to materialize, but in the end, I think they will come to that the connection lines will be paid for by the state. And then, yes, how they will be distributed to people in taxes or how they will do that on the network tariffs, we will have to see.

Hollandse Kust 3 and 4, I'm not sure whether we have really decided that. I don't think so.

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**Anna Borg Vattenfall AB - Chief Financial Officer**

We have decided on the turbine model ...

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Yes.

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**Anna Borg Vattenfall AB - Chief Financial Officer**

... which is the Siemens Gamesa 10 megawatt turbine.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Yes. Okay. So it's - yes.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

And then there was the question about the FID for 3 and 4.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Okay. That we haven't set yet.

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**Markus Friberg Vattenfall AB - Communications**

I have one more here if I should ...

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**Karin Lepasoon Vattenfall AB - Head of Communications**

Yes. Of course.

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**Markus Friberg Vattenfall AB - Communications**

Yes. Then we have a question from Andreas Zsiga from Nordea.

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**Andreas Zsiga Nordea - Analyst**

Could you provide a ballpark figure in billion SEK for how much EBITDA and FFO you will lose on an annual basis when closing the Ringhals units, losing the Hamburg heating operation and losing of the Berlin distribution business?

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

We won't give any guidance like that. So I don't think we have - I will not. No.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

All right. That was it, I believe, on the web and there are no further questions on the telephone. Any questions here in the audience in Solna? That doesn't appear to be the case. In that case, thank you very much for your attention and that concludes this meeting. Thank you very much.

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**Magnus Hall Vattenfall AB - Chief Executive Officer**

Thank you.

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**Anna Borg Vattenfall AB - Chief Financial Officer**

Thank you.

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**Markus Friberg Vattenfall AB - Communications**

Thank you.

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**Karin Lepasoon Vattenfall AB - Head of Communications**

Thanks.

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