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Q4 2019 Vattenfall AB Earnings Call

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CORPORATE PARTICIPANTS
Karin Lepasoon  Vattenfall - Head of Communications
Magnus Hall  Vattenfall - President and CEO
Anna Borg  Vattenfall - CFO
Markus Friberg  Vattenfall - Director of Media Relations

CONFERENCE CALL PARTICIPANTS
Victor Emil Kristensen  Energy Watch
Adnan Durakovici
Andrew Moulder  CreditSights - Analyst
Jeroen Savelkouls  Energeia

PRESENTATION
Karin Lepasoon  Vattenfall - Head of Communications
Good morning and welcome to this presentation of Vattenfall's Full Year Results 2019. In a moment, we'll hear from our CEO, Magnus Hall; and our CFO, Anna Borg.

As usual, this is a live meeting here in Solna combined with the webcast and a telephone conference. And after the presentations, we will open up for questions.

So with that, Magnus, over to you.

Magnus Hall  Vattenfall - President and CEO
Thank you. Thank you very much. And also from my side, a warm welcome to this morning's presentation of Vattenfall full year results 2019 and quarter four results.

We had a very positive year, 2019, which is seen by the fact that we managed to deliver on our two main financial targets that the owner has set up, that's return on capital employed, and that's also FFO to adjusted net, both those targets we were able to meet. And we also took significant steps towards a fossil-free future, making fossil-free living possible within one generation.

We see customer growth, we see increased wind capacity. We had record high distribution investments. And we also have phased out of coal-fired power generation as part of that development.

The underlying operating profit increased by 26% to SEK25.1 billion for the full year, it's mainly driven by higher electricity prices combined with stable nuclear and hydro production. But we also have increased contribution from new wind farms coming in at the same time as the distribution business was hit negatively by an impact of the Alfrida Storm at the beginning of the year.

Profit for the period increased to SEK14.9 billion, that's, again, roughly 25% increase, strong result, underlying result but also mitigated by nuclear provisions and higher tax, but then also supported by the fact that we sold our heat business in Hamburg, and also we sold nuclear production rights in Germany.
The board of directors is now proposing a dividend of SEK7.2 billion, which is an increase of SEK5.2 billion versus the SEK2 billion paid out during last year.

We can see that a little bit more in detail on this picture where we can see that all the net sales increased by 9%. We can also see that all on the different lines where we are reporting profits that we have an increase around 25%. And you can see to the right here that the capital, return on capital employed reached 8.5% versus a target of 8% and the FFO to adjusted net debt was in the range in the high section of the range 22% to 27% with 26.5%.

Customer sales, if you look to electricity, was roughly stable. We had customer growth. But, then again, due to warm weather, they were actually per customer using less. We can see that also from gas sales, we can see that those are from heat sales, that due to warmer weather the sales went down a little bit.

To the right, you can see electricity production and that's actually reflecting the change. If you just look at nuclear, we have slightly lower production there because we are closing Ringhals 2 and we slowed the production during the year until the closure in the last of December.

You can also see we reduced fossil power production, and what is, of course, very important for us, we increased the wind power production as you can see to the right. On the total, the production was roughly the same as last year.

We have a set of strategic targets, I'm not going to comment on all of them. But you can see that the CO2 emissions last year amounted to 19 million tons in total versus last year, 22 million tons, and that's actually lower coal-fired power generation. I will come back to that because we now see a clear shift also in the way electricity is being produced in Europe. I just commented on the return on capital employed.

We have figures for lost time injury frequency, which means health and safety issues where we are not fulfilling the target. And where we are clearly on an unsatisfactory level and we are putting major efforts into turning this trend into something that is going towards our targets, the 1.25. This is a very important task for the company.

And employee engagement, you can see is clearly up from 64% versus 69%. And that's a significant change if you look to this way of measuring, and we are quite happy about that strong improvement. It really means that people in the company are driving and are engaged in what we’re doing.

Very shortly about the strategic direction of the company hasn't changed. If you look to this picture, we normally use a four field picture, we’re changing that to a five and we’re really talking about a situation where from the right, want to make sure that we are a fossil-free power and heat producer, we are investing there in wind power as you know, we have a very high and stable production from our nuclear and hydro operations, and we have, of course, a change that we need to do in our heat operations where we’re going from fossil-based production then to other solutions.
And to the left, you can see that we are now looking then for customer solutions where you will use electricity rather than traditional fossil fuels, typically transportation, charging infrastructure, typical heat where you go from gas-fired heat to heat pumps, electricity-driven, and also in the industrial side where we look at solution, where electricity can replace traditional fossil fuels.

What we’re doing now is just showing that this is a combination. In the future, we need to make sure that we optimize, balance those markets because we will have more electricity consumption, and we can see now the importance of this middle section coming up where we’re going to both connect the systems where grids and grids investments are extremely important because we need to transfer the electricity where it's needed, but also to optimize the energy system so that we make always the cheapest choice of delivering electricity either by delivering more electricity or actually reducing the consumption in the other end of the system.

And this is something where if you connect all of this, you could see clear strategy from the Vattenfall side going forward. And, of course, we want to be a leading company, making it possible to live fossil-free within one generation. And that we need to do by the two ones empowering our people and make sure that we are really keen on delivering good financial results and an efficient operation.

So let's go to the business areas, a few comments on them, customers and solutions, our retail business, and also solutions for our customers, our B2C customers and some B2B customers. We can see that we are growing in terms of customers, but there is also quite a significant competition in this market.

So at the same time as we are growing, we are having impacts on the earnings because of this competition and also costs for the growth. You can see here that we have a target which is a net promoter score, which means how are we appreciated by our customers. The target was to improve relatively to our peers by two points. We managed to do one which is good, but not good enough and we need to make sure that we are appreciated by our customers and even more so than our competitors.

The profit, this was roughly the same as last year. As you saw during the first quarter, second, and third quarters this year, we were behind but we managed in the last point, last quarter of the year actually to improve, customer growth in Germany helped us and we have also increased the contribution from other parts of the markets.

We increased our customer growth also by an acquisition in the Netherlands, DELTA Energie, which is now belonging to the company and run under the trademark of DELTA Energie. And we have one quite interesting pilot project right at this moment where we are running a system where together with Microsoft where you can make sure that you can see how much renewables and fossil-free electricity you are actually producing and then using at the same time so that you can connect the sources. This could be a very interesting future development where you can actually measure the electricity that you use and the quality of that electricity.
And you can see that we are expanding in charging infrastructure. Here we are mentioning Berlin waste management, the cooperation with Honda which is introducing a new e-car, electricity-driven car in Europe. And then also so we do it with housing cooperatives. We do it this time together with a Swedish one.

And you can see to the top right there that we’re growing in terms of charging points for electrical vehicles, which is something that is absolutely necessary to make the changeover from fossil fuel cars to electricity-driven cars possible.

Power generation is then the Swedish hydro and nuclear generation, of course, it's also our services business in Sweden. So our nuclear decommissioning operations in Germany and our pump storage in Germany. We are the biggest supplier of pump storage capacity, hydro pump storage capacity in Germany, that's something that sometimes is overlooked.

Here, you can see a considerable increase in underlying operating profit. It's good stable production, but it's also increased prices. And mainly increased prices because of the hedges that we're doing, and we are benefiting from that here. The nuclear generation as I commented earlier, is slightly lower because of the closure of Ringhals 2 and at the end of this year, we will then also close Ringhals 1.

If you take a brief look to the right and in the middle, you can see the chart depicting the situation for prices in the Nordic system and also hydro balance. And there you can see during last years, we had a very weak hydro balance and then also very high prices.

What we're seeing right now in the market is a change, the hydro balance has improved significantly in the Nordic system during the last month. And we have also seen prices now coming down quite considerably and that can be shown in this picture.

We also see a long-term price decline in Europe or, sort of, during the last year or a price decline because we see coal and gas prices being low. And so this development is what we currently see. Of course, it's because we have a warm weather system, we have a lot of water in the system, so it is not really reflecting of a long-term situation but you will have those changes during the year.

The Nuclear Improvement Program is on track, we have a target to reduce costs and that is going on into the right direction.

Wind, of course, we have positive contribution from new wind farms but we also had lower prices. We are affected here, we are not only delivering into systems with fixed prices but also open market prices, and we have had some effects on that. But you could see to the right that we have now totally installed capacity of by the end of 2019 or 3.3 gigawatt versus 2.85 gigawatt the last of December 2018. So, we are increasing.

And in this year, we inaugurated and started up our Horns Rev 3, 400-megawatt offshore wind farm
outside Denmark and we also won the Hollandse Kust Zuid 3 and 4, which is then adding to the 1 and 4 that we won earlier. So together, Hollandse Kust Zuid 1 to 4 will be right now the biggest, largest offshore wind farm coming on stream in the world and it is subsidy-free.

We have barrels on agreement with Siemens Gamesa out on 11 megawatt turbines that will be placed into that investment. And we are constructing now the Kriegers Flak also in Denmark, 600 megawatt wind farm.

The underlying operating profit here you could see increased from SEK3.7 billion to SEK4.2 billion.

Heat, here, of course, step out of coal is a very important part. We closed two big coal-fired power plants in 2019. One in Amsterdam, the Hemweg-8 at the end of the year and during the autumn, we also closed something called Reuter C in Berlin, a coal-fired power plant, roughly together 4 million tons of CO2 emissions that went out.

Here, we are suffering from the pricing situation in Europe for CO2 and coal and gas, which means that gas is very much more in the money right now. So, coal-fired power plants have a problem, they have lower running hours and less margins, which is then also affecting our result, as you can see from this picture. And we also had a warm situation during the year affecting our heat sales, and we are reducing our underlying operating profit from SEK770 million to SEK550 million.

But we do grow, we continue to grow in terms of district heating business. If you take down the side, of course, the fact that we have divested the Hamburg business which went out it was not part of the fourth quarter results here. And then, yes, I think we are then also replacing some of these coal-fired power plants with gas-fired power plants in Berlin. And we have here a few projects which are about to come online during this year.

You can see to the right the clean dark and clean spark spreads here, this is an average for the market. But you can also see clearly why there's more gas-driven production than coal-driven production if you just look at the picture there.

Distribution, we have record investments. In Sweden, we increased for the grid investments to SEK5 billion, that's an increase in 7%, that's the highest level we have had so far in terms of investing during a year. And that's absolutely certainly needed when it comes to the fact that we need to continue to make sure that the electricity is then distributed to where it's needed.

If you look to the big issue around Sweden, it's not a real issue about energy and the production of energy, but the issue is about delivering the energy to where it's needed. And we have growing cities, we have more connections to renewables, and we also have some big new energy consumers that needs to be connected. So this whole thing is very much about grid investments.

And for us, of course, now, the result here was lower than last year, we had SEK6.2 billion in 2018, and
roughly SEK5 billion this year. Main reason for that is, of course, the storm Alfrida at the beginning of the year where we had significant issues after the storm in both replacing and repairing the electricity grid system, but also paying out penalties for the fact that a lot of users were without electricity for quite some time.

The problem with the storm was, of course, it was coming from a totally, say, wrong direction, it was coming from the north when the predominant wind direction is something like southwest, and that made trees and all things react in a different way than normal.

So that is roughly SEK1 billion, close, a little bit less than SEK1 billion that we were affected by that. But, again, we had record investments in total, but if we look forward now, of course, the fact is that we have a new regulatory system coming in and that the framework for investments and the possibility to get paid for those investments is less, and we need to look at how we will deal with this, over time, investments will have to go down unfortunately due to this fact.

But there is some positive effects. Also, we will have a little bit of help from the fact that we can probably use old reserves that we've had in our framework also for investments going forward. So, some things are also positive.

When it comes to Berlin, we are still in a concession process and appeal process where we won the last part of that and then we will just see how that develops in terms of what will come out. We have offered earlier a discussion around 50% cooperation with the city, but we now need to deal with a concession process first and see where that lands.

So just to finish off, we want to have a leading role in the energy transition, that's clearly from what we're doing and all the milestones that we are showing with the development in our company. Of course, we're very happy now that we can also report on a positive development in terms of financials. But just this picture is just to show a lot of things that we're doing at the same time to make possible fossil-free living within one generation.

Looking at the fossil-free steel here in Sweden, we're looking at hybrid power plants, which is a combination of perhaps wind power, solar power, a storage system so they can actively use your grid connection and be more stable supplier of electricity. We're looking at local flexibility markets when it comes to the grids in something called Coordinet, which is a very interesting and that could be combined then also with storage, something that we are working on because you will need to balance the system also locally more in the future. Looking at hydrogen conversion of one of our plants in our gas plant in the Netherlands, first with blue hydrogen and then later on, of course, with green hydrogen.

With Hemweg-8 plant which is outside Amsterdam, which we closed now, we will look to have that as sort of a place where we can produce more fossil-free electricity, investment, perhaps in wind, look at all new different solutions that can actually help us to bring ourselves to the fossil-free solution within one generation.
So we're doing a lot of things, but we are also very happy that that goes along now with good a financial result.

And with that, I would like to leave the word then to Ann Borg for further deep dive into the financials. Thank you.

Anna Borg Vattenfall - CFO
Good morning. Let's have a deep dive into the financial results for full year 2019.

I would like to start by saying that we see an increased net sales of SEK14.3 billion, which means that the total net sales for 2019 is SEK166.4 billion. The improvement is mainly due to higher achieved prices, which is the combination of market prices and our hedges. It's also increased net sales and increased wind assets being up and spinning compared to 2018.

Also, our underlying EBIT is improving by SEK5.2 billion, which means that the full year 2019 underlying EBIT is SEK25.1 billion compared to SEK19.9 billion last year. This is mainly due to increased contribution from our generation segment, but it's also due to the increased contribution from wind. On the other hand, we do see increased cost related to the storm Alfrida of approximately SEK1 billion. We also have increased transmission costs and increased the depreciation due to our increasing investments.

Then we also have a number of one-offs both positive and negative, but the net effect is minus SEK3 billion. These one-offs are mainly fair value changes, which is a pass-through position for mainly our financial derivatives. So both when they go into our P&L with a positive result, that has a negative impact on the fair value changes, but it's also our hedge transactions that are not hedge accounted, which are then affected from the prices going down both short and long-term. So this will vary over time.

We also have increased nuclear provisions and we have the capital gain from the sale of Heat Hamburg. We also have the sale of nuclear production rights. And most of these one-offs are coming in during Q4, which is also why the numbers look a little bit skewed if you only look quarter-by-quarter.

All-in-all, this means that our return on capital employed which is supposed to be at 8% or above is now 8.5% and our FFO to adjusted net debt, which is supposed to be somewhere between 22% and 27% is now 26.5%, compared to the numbers last year, which were 7% and 20.7%, respectively.

Looking into our businesses, a bit more in-depth. The customer and solution businesses is increasing their result compared to last year. That is among other things due to increased customer growth, especially in the German markets. But we also have been able to manage quite competitive market situations both in Sweden and Netherlands in a good way.

Our generation business is performing very much better, again, it's a combination of market prices and hedges that have an impact here. And we also have a good year in our trading business contributing with
a positive result.

In our wind business, it's mainly the new capacity that is contributing to the increased results. And in heat as we heard earlier, we have a challenging situation due to the various squeezed clean dark spreads. So it's mainly our condensing coal-fired power plants that are not performing as well as they used to historically. We also have a slight increase in maintenance costs in our heat business in order to secure the quality in our deliveries.

In our distribution business, we do see a decreased result related to the Alfrida Storm as mentioned, but also due to the increased cost of transmission.

I would like to say something about the cash flow development. As you can see, we have a working capital of minus SEK18.2 billion. You might recall that already in the third quarter it was minus SEK13 billion. The main driver here are margin calls, which means that there is a daily settlement basically of our financial transactions.

And there's a lot of in- and outflow, so large swings, but if you recall our Q4 report last year, for Q4 2018, we had a plus of SEK17.8 billion. So over time, the net here is basically zero.

Taking a look at our capital expenditures, you can see that we invested SEK24.9 billion during 2019, 31% of that went into our wind and solar business and 28% into our distribution business.

The piece of the pie that is called other here is our acquisition of DELTA Energie in the Netherlands mainly. And looking forward at our investment plan for this year and also next year, we will invest in total SEK58 billion, SEK35 billion out of those are going into growth and 70% of that is going into wind.

The main countries that we will invest in when it comes to wind the next two years is the Netherlands and Denmark. This will vary a lot over time depending on in which country the main projects are being built at the moment.

On top of that, we have more than SEK20 billion in maintenance and replacement investments.

So if we look at the total numbers, you can see that there is a clear improvement versus 2018 in many regards. If you look at the quarter four to quarter four numbers, you can see an impact which is mainly driven by warm weather but also by very low prices, especially in the Nordic market.

The price today, the Nordic spot price today is EUR17.43 per megawatt hour, that's approximately half of what it was in July. So it's extremely low prices that have an impact in this quarter, especially from December.

And we also have the one-offs in Q4, especially then the fair values and the increased provisions, so that is why the Q4 numbers look slightly skewed.
Total for 2019, we then see an increase of our EBITDA of 24% compared to 2018, and an increase of our EBIT by 26% compared to 2018. This means that we for the first time since 2012, reached and exceed our financial targets coming in at a return on capital employed of 8.5% and an FFO to adjusted net debt of 26.5%. That's a very important milestone for us because it also shows that our aim to enable fossil-free living in one generation is a profitable business and strategy. Thank you

QUESTIONS AND ANSWERS

Karin Lepasoon Vattenfall - Head of Communications
Thank you, Anna and Magnus. We now open for questions. Either here live in Solna or from the webcast or from the telephone conference. But as we are here in Solna, we start by inviting our guests here and ask if there are any questions from the audience.

That does not appear to be the case. In that case, Markus, how about from the webcast?

Markus Friberg Vattenfall - Director of Media Relations
Yes, thank you. We have a couple of questions from Energy Watch in Copenhagen, Victor Emil Kristensen, is it realistic for Vattenfall to meet the 2020 target of 2,300 megawatts in renewable capacity? And do the changes in cash flow and/or the higher net debt raise any concerns for Vattenfall?

Karin Lepasoon Vattenfall - Head of Communications
You have two questions there.

Markus Friberg Vattenfall - Director of Media Relations
Yes.

Magnus Hall Vattenfall - President and CEO
I can start with the first. And, of course, we are a little bit behind, but we have several projects coming in. So we will not be reach it by 2020, but we expect to reach it by 2021.

Karin Lepasoon Vattenfall - Head of Communications
Yes. Thanks. Anna, you take the one about the cash flow?

Anna Borg Vattenfall - CFO
And the cash flow situation is overall good, I would say. We do have the margin calls this year. But as I said earlier, we had a lot of positive swings in the margin calls last year. Overall, it's basically zero. It's money in and out, but definitely manageable.

When it comes to the net debt, we are not concerned, it's also a consequence of our increased investments. So we are basically following our investment plans and also our development of the
business plans going forward.

Karin Lepasoon  

Vattenfall - Head of Communications

All right. More?

Markus Friberg  

Vattenfall - Director of Media Relations

Yes. We also have a question from [Adnan Durakovic] in the Netherlands. When is the offshore construction of the Kriegers Flak and the Hollandse Kust Zuid 1 to 4 offshore wind farms expected to start?

Magnus Hall  

Vattenfall - President and CEO

Kriegers Flak will be operational at the, what was it, the end of '21, I think. And then we will have a successive start of offshore wind farm, Hollandse Kust Zuid 1 to 4 beginning of 2023.

Karin Lepasoon  

Vattenfall - Head of Communications

All right. And, of course, we have those dates available in the material as well, in the report also. Thank you.

Markus Friberg  

Vattenfall - Director of Media Relations

Yes, I can continue. We have also a question from Andrew Moulder of CreditSights. You talked about the investments in distribution going down due to lower returns from 2020. But you also said you made record grid investments in 2019. Will the 2019 investments be renumerated at the old rate or the new lower rates?

Magnus Hall  

Vattenfall - President and CEO

They will always be remunerated at the rate that you have at the time when you have this regulatory period, they will be remunerated at that point in time. So if we have a difference then after this regulatory period to the next, then that will also affect the RAB, the regulated asset base where all the investments goes into. So over time, this will move from year-to-year or for four-year period with a regulatory issue. So you don't sort of invest into one system and then you have that for the future.

Karin Lepasoon  

Vattenfall - Head of Communications

All right. This was the last question from the webcast or, did we have any other?

Markus Friberg  

Vattenfall - Director of Media Relations

We have more here.

Karin Lepasoon  

Vattenfall - Head of Communications

Okay.

Markus Friberg  

Vattenfall - Director of Media Relations

So I can take also one from Jeroen Savelkouls Energeia in Amsterdam, could you please elaborate some
more on the plans for Hemweg?

**Magnus Hall Vattenfall - President and CEO**
Yes. I mean, this is we have very early stage on the Hemweg operation, the idea is to make that the center for fossil-free energy production of various sorts, where we would together with partners we show that it is possible to do things. So it’s like a development and a site and the site where we invite partners to come to help us and look at new things.

So the plans are not clear, but we can see that we believe that closing a coal power plant and then showing that you can do new different things is also a place where you can actually attract people and you have a good story around the change. So that's what we're looking at.

**Karin Lepasoon Vattenfall - Head of Communications**
Good.

**Markus Friberg Vattenfall - Director of Media Relations**
Yes. Okay.

**Karin Lepasoon Vattenfall - Head of Communications**
That's it on the webcast. And we have nothing on the telephone either.

Any questions here? No, that's not the case. So with that, thank you very much for your attention. Thank you, Magnus and Anna. Thanks.

**Magnus Hall Vattenfall - President and CEO**
Thank you very much.

**Anna Borg Vattenfall - CFO**
Thank you.

**Karin Lepasoon Vattenfall - Head of Communications**
Bye.

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