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CORPORATE PARTICIPANTS

Andreas Regnell *Vattenfall - Head of Strategic Development*

Anna Borg *Vattenfall - CEO*

Kerstin Ahlfont *Vattenfall - CFO*

CONFERENCE CALL PARTICIPANTS

Andrew Moulder - *CreditSights – Analyst*

Jakob Magnussen – *Danske Bank – Analyst*

Maz Plechinger - *EnergyWatch - Journalist*

Philip Akoto - *Energate - Analyst*

PRESENTATION

Andreas Regnell - Vattenfall - Head of Strategic Development

Welcome to Vattenfall and this Q3 Reporting Event. I'm Andreas Regnell and with me here in the studio, I have Anna Borg, our CEO and Kerstin Ahlfont, our CFO.

Anna Borg - Vattenfall - CEO

And 2021 has so far been a very unusual year for Vattenfall, but also in the markets. We have closed a number of important actions that has a big impact on our result. But we also experience an extreme volatility and very high prices on the energy market.

I think it's important to remember that this is not a standard quarter for Vattenfall. We see a lot of one-off effects that have a big impact, but underlying, we are experiencing a stable result, which I think is good in the market environment like the current one.

Kerstin Ahlfont - Vattenfall - CFO

And financially, we are currently in a very strong position. But as I will explain later, the result this quarter is not explained by the higher prices. The result is instead explained by several one-off items and some temporary items which distort the comparison.

Andreas Regnell - Vattenfall - Head of Strategic Development

As usual, we will open up for questions after the initial discussion on the web and on the phone. And our standard slide pack is available on the web. But Anna, let's now start with looking forward.

In a few days, COP26 will start in Glasgow. What are your expectations on the summit?

Anna Borg - Vattenfall - CEO

Well, I think it's no understatement to say that all the world's eyes are now on the leaders in COP26 and in Glasgow. And I'm hoping for renewed commitment to the 1.5-degree target, but also some actions to see that we are really on the right way.

We at Vattenfall also need to do our part. So we have stretched our ambition even further. We recently announced that we are aiming for the 1.5-degree target trajectory in the Paris Agreement and also to be net zero in 2040.

We've also decided to become a founding member of the First Movers Coalition. That's an initiative by the US presidential special envoy for the climate, John Kerry. And it's aiming at corporations committing to buying a certain percentage of fossil-free products and services in their operations by 2030.

This is an initiative that will hopefully speed up the commercialization of new technologies. And I'm really hoping that more companies globally will join, because then it can really have an impact. And this will also be launched at COP26.

Andreas Regnell - Vattenfall - Head of Strategic Development

You mentioned our newly announced commitment on, to the science-based target, the 1.5-degree trajectory as well as the net zero commitment on the 2040. What does it mean in practice for Vattenfall?

Anna Borg - Vattenfall - CEO

Well, it is an increased ambition, it might not sound a lot to go from a 2-degree trajectory to 1.5-degree, but it's actually a big difference. So it, for example, it means that we need to decrease our CO2 intensity by 77%, between 2017 and 2030, but it also means that we need to put demands on our suppliers to decrease their CO2 footprint. And we need to provide products and services that enables our customers to also reduce their emissions.

I think that one of the main challenges for us will be to replace natural gas in our operations. We know pretty much how to replace coal and have solid plans for that and we are in the middle of it. And then we also need to replace natural gas. And there the challenges are slightly bigger. And all in all, this challenge is a stretched one, but it's also doable to deliver on this. I'm absolutely certain and we are already on our way. So it's not that we're starting from scratch. We are already on this trajectory.

When it comes to investment plans, because we had questions about that earlier, we usually present the two-year investment plan. Although we, of course, have a planning in the company where we also look at different time dimensions. So we will also update our investment plan and show the revised one in February when we present the year-end results. So then there will also be more information.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you. So quite clear what we need to do in the medium to long term. But let's now go to the here and now. We talked a lot about, already, about the volatile prices and what has that had an impact for Vattenfall in financial terms?

Kerstin Ahlfont - Vattenfall - CFO

Well, as I mentioned earlier, we see a lot of one-off effects, but also some temporary effects which are indeed driven by the market environment. But I would like to start off on an underlying basis.

And the first thing I would like to mention is that this quarter, compared to the same quarter last year, we actually had lower achieved prices in the Nordics, which might sound surprising. But as you are aware, we are hedging a lot of our production in order to balance our risk profile.

And in a rising price environment, then we get the negative impact from those hedges. And we also have an average hedge price, which is lower this quarter compared to last year. And adding to that, we see a negative impact from price area differences which are driven by the lack of capacity between different price areas in the Nordics.

Andreas Regnell - Vattenfall - Head of Strategic Development

So, so far, no positive effect at all of the increased price?

Kerstin Ahlfont - Vattenfall - CFO

Not on the underlying result, but of course, over time, higher prices has a positive impact on us.

But adding to this, we see also negative impact actually from the higher prices in our distribution business as well as in our heat business. So although we are actually selling more to our customers and we are also producing more fossil-free electricity, if we compare this quarter to the same quarter last year, the development of underlying EBIT is actually flat on SEK 4.8 billion.

Andreas Regnell - Vattenfall - Head of Strategic Development

But then you mentioned temporary effects and one-offs, they must be very significant as the reported numbers are so strong.

Kerstin Ahlfont - Vattenfall - CFO

Yes, our financial targets are on an exceptionally high level right now. If you look at the rolling 12 months FFO over adjusted net debt, that is 182.7% and ROCE is on 22.4%. And if I start with ROCE, there we have the one-off effects from Stromnetz Berlin, the divestment there and the compensation we got from the early closure of the German nuclear. Together, they impact ROCE with approximately 5 percentage points.

And in addition to that, we also have a significant impact from unrealized changes of fair values of energy derivatives and inventories. Also that is approximately 5 percentage points. So if you would calculate ROCE on an underlying EBIT, then it is on 11.4 percentage points.

Andreas Regnell - Vattenfall - Head of Strategic Development

A lot of percentages there. And just to understand, this is monetary terms. What were the items affecting comparability if you translate it into SEK?

Kerstin Ahlfont - Vattenfall - CFO

Well, firstly, I would just like to correct, it's 11.7% ROCE. But coming to your question, there are basically three main items. The first one is the closure of nuclear in Germany, the compensation, which comes into the result with SEK 12.5 billion in total. Then you also have the divestment of Stromnetz Berlin, which gave a capital gain of SEK 8.4 billion. And then we also have then these unrealized changes of fair values of energy derivatives and inventories on SEK 12.3 billion.

So in total, these items affecting comparability amounts to SEK 30.4 billion. And maybe to put that into a context, you can compare it to the total EBIT of SEK 52.5 billion.

And if I then proceed to FFO over adjusted net debt, we see a major impact now from the inflow of margin calls, which reduces our adjusted net debt quite significantly. And if I would deduct that impact from this financial target, then FFO over adjusted net debt is 36.1%.

Andreas Regnell - Vattenfall - Head of Strategic Development

A huge impact indeed. Maybe you can explain a bit more.

Kerstin Ahlfont - Vattenfall - CFO

Absolutely. So margin calls, that is payments from our counterparties in the commodity market and it is linked to our hedging activities. And this increase is actually due to the sort of exponential increase we have seen in electricity prices, fuel prices and EUA prices on the continent.

And even though we have the opposite effect in the Nordics, these price differentials on the continent are so big, this gives this large impact on our adjusted net debt. But important to mention is that when the underlying deals go into delivery, then this flow will be reversed. So it's temporary.

Andreas Regnell - Vattenfall - Head of Strategic Development

So that's clear that the biggest impact on FFO is from these margin calls, but there are some other one-off effects as well, weren't they?

Kerstin Ahlfont - Vattenfall - CFO

Exactly. We had the closure of Stromnetz Berlin, which took place now in the third quarter which impacts FFO over adjusted net debt. We also had the sale of production rights in nuclear in Germany in the fourth quarter last year and in the first quarter this year. And then we also have the divestment of 49.5% of Hollandse Kust Zuid to BASF. And in total, these effects amounts to approximately 11 percentage points on FFO over adjusted net debt.

So if you start with the 182.7% and then you deduct the margin calls, you end up at 36.1. And then you take out these one-off effects, then you are roughly on the 25%, which is our target that we have.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you, Kerstin, very clarifying. So the key messages that we've had is stable performance underlying, but quite some effects distorting the comparison, just as you mentioned in the beginning.

Anna, are there other business highlights that you would like to mention?

Anna Borg - Vattenfall - CEO

Well, after a very eventful first half year, the third quarter has been slightly more normal or keeping up the good work in the business, but in addition to what Kerstin has highlighted, there are a few things that I would like to mention.

We have inaugurated Kriegers Flak, which is a wind farm offshore in Denmark. It's actually Scandinavia's largest offshore wind farm. And so that was an inauguration we had in the third quarter. This is also unique in a different aspect, because this is actually the first wind farm that is connected to two transmission operators, both the German one and the Danish one.

And I think we will see more of these going forward, which is also a really good way of sort of utilizing the offshore wind where it's most needed for the moment. So I think that's sort of a big stepping stone that this project is also an evidence of.

We pre-qualified together with wpd and BlueFloat Energy for an offshore wind tender in France. It's a floating one. This is interesting for several reasons. First of all, France is an interesting market for Vattenfall. Floating is a technology that's going to be more common as we go ahead. And we also anticipate a quite increased ambition when it comes to renewables in France. So this is an important step for us.

We have a customer business that is progressing well, both from a commodity perspective, but also when it comes to E-mobility where we see continued growth in those products and services. Our power generation has actually produced more this year than last year, both in the nuclear operations and the hydro operations. And we also see more wind capacity coming online actually.

Then we have a good trading result in our books and we also have an increased interest in flexibility products. We have talked about that in these events before, the importance of flexibility in the market. And now we see that's picking up pace a little bit.

And we have, for example, signed a contract with Nobian, the chemicals company in the Netherlands where there is a flexibility component. So they will actually adjust the production of one of their chlorine plants, depending on the access of renewable energy at the moment. So that's also a sort of interesting solution to say something about.

When it comes to our heat business, we have invested in increased capacity in the district heating system in Amsterdam. And we have also started the operation of the biofueled plant Carpe Futurum in Uppsala. It will be fully up and running in a few months, but it's already producing now.

We've signed a collaboration agreement with a waste company called Cory Environmental in London, which is one part of our ambition to develop district heating in the different parts of London. And finally, maybe our distribution business because we actually see an increased inflow of requests to connect to the grid.

Only in August, until August this year, we had just as many requests as we had for all of 2020. So we can really see that things are picking up pace here.

Andreas Regnell - Vattenfall - Head of Strategic Development

And we are awaiting additional clarity on the revenue frames with Swedish DSO, aren't we?

Anna Borg - Vattenfall - CEO

Yes, that's true. We're still actually waiting to see whether the legal process will continue in the next instance or not. And there was a similar case against the German state where the European Court of Justice recently came with a verdict that actually strengthens the Swedish DSO's positions even further. But we will simply have to wait and see.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you. So in summary, we live in very turbulent times and it's very challenging for us and other energy companies, but so it is for our customers. And we fight hard and work hard to stay stable in this environment while executing our strategy.

And Kerstin, you talked about the impact of the volatile and high electricity prices on our business. But I'd like to take that in the broader context, and I think the drivers of the high electricity prices on the continent is slightly different from the Nordic. On the continent, it's pretty straightforward, it's the very high and volatile gas prices in combination with higher CO2 prices.

In the Nordics, that's combined with the hydrological balance and transmission restrictions from the north to the south of Sweden, which has created this large price differences within Sweden. So gas price is apparently very important and why then the high gas prices. And I think it's fair to say that we hit a perfect storm. We had a very quick bounce back from Corona, creating strong increased demand across the globe and particularly LNG in Asia. And the LNG, why that is important, is typically the swing capacity in those markets.

We combine that strong demand increase with low reserves in Europe after a cold winter. And we top that up with uncertainty when the Nord Stream 2 will come into operation. And we believe that these high and volatile gas prices will prevail at least throughout the winter.

The CO2 prices however, we think will be high more on a permanent basis. So coming back to what are then the impact of all of this on Vattenfall? And I think we touched upon it a bit already, but of course, the high electricity prices or higher electricity prices are positive for Vattenfall over time. But given our hedging strategy, there is a time lag between what we see in the market and what we see on our income statement.

When we get to the impact on our district heating business, it's more complex. In Sweden, of course, the gas price is of lower impact, but if we talk about our continental district heating instances, particularly the one in Berlin, it's more complex, because that is the gas spread is an important component of the profitability. And many of our combined heat and power plants have must run characteristics, which means that sometimes we need to run them even if the electricity part of the business is not profitable.

On top of that, we have the pricing of the heat, the deliveries are indexed, which doesn't necessarily always tie in perfectly with reality. But if we take all these factors into account, there is a small, but negative impact on our district heating business of the higher gas prices.

An indirect effect of the large move is, as has been indicated already, of course the large cashflow swings from the margin calls, but also the large swings in the fair value valuation of our derivative contracts.

And the impact of the other businesses is limited, but worth mentioning is that the very high and volatile prices makes it very difficult for actors to offer attractive terms to B2C customers. Meaning that the churn in our B2C business is essentially stopped because there is very limited ability to offer new attractive contracts.

On top of that, some of the smaller players have not been properly risk managing their portfolio, meaning that they go bankrupt. So that's a small inflow of customers coming from those bankruptcies. Another that's also been mentioned smaller impact on our business is the fact that the energy losses in our distribution network, because of the high prices cost more, but those cost increases we can recover in later periods.

I think a key question for us and the energy market is what this development will mean in terms of the market and price mechanism regulation. As you know, there are lots of discussion in many countries, but also on an EU level, what can be done to dampen the effect of what's often referred to as the energy crisis. There are many different views, but so far, the only action is that there are significant discussions on whether it is possible to do cash transfers to the most vulnerable consumers.

There are, however, also discussions on fundamental reregulation of the market. They haven't come very far, but it's something we clearly have to monitor very, very closely.

Now, Anna, what does it mean for Vattenfall, all of this in concrete terms going forward?

Anna Borg - Vattenfall - CEO

Well, although we have seen a lot of volatility in the European market, energy market also in the past, I think we need to say that what we see now is exceptional, both in terms of volatility and the extremely high prices.

And this, of course, there is a risk that this will continue over the winter season that we're now entering into, because normally that is when demand is increasing and prices are slightly higher. So this will also very much be interlinked with how much wind will there actually be during the winter season.

But I think we can expect continued volatility and uncertainty also over the next few months and quarters. And this, of course, poses difficulties for our customers, as you just said and it will also impose risks on all actors in the market.

So for us in Vattenfall, it's very important that we are, as always, prudent in our risk management, we look into how we can mitigate these risks in different ways. And we especially make sure we have the financial flexibility that is needed especially from a liquidity perspective in order to make sure that we can manage this. So there's a lot of focus on that as well.

I think that long term, we, but also other actors, bring more fossil-free energy into the market. And that will lower the dependence from fossil fuels like coal and gas, which are one of the main drivers of the high prices right now. So the green transition is actually also one part of the solution here, although long term.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you, Anna, I think excellent final words. And with those words, we open up for the Q&A.

QUESTION AND ANSWER

Andreas Regnell - Vattenfall - Head of Strategic Development

And we have our first question from Andrew Moulder.

Andrew Moulder - CreditSights - Analyst

Please, can you comment on the derivatives margin payments. With power prices high, I would have expected you to be paying variation margins on forward power sales and receiving margins on gas and carbon since you will have forward purchases there.

Please, can you give an indication on how much you have received and paid in variation margins on the various commodities? Question number one. Could you also break down the cash margin receipts and payments on the Nordic market as opposed to outside the Nordic market, e.g., Germany?

Kerstin Ahlfont - Vattenfall - CFO

Well let's take the first question first. We have a portfolio where we are sort of producing more electricity in the Nordics than we are selling. On the continent, we have the opposite situation. So there, we're actually selling more electricity and gas than we are producing. So that is why we get this imbalance and also the inflow of margin calls.

So in total, you can say that when the prices rise on the continent with our structure, then we will get an inflow of margin calls. When the prices fall on the continent, then we will have an outflow. And year to date, we have an inflow of margin calls of SEK 78.9 billion in total. And if you look at the accumulated margin calls, that is 86.4 billion at the present time.

Andreas Regnell - Vattenfall - Head of Strategic Development

I think...

Kerstin Ahlfont - Vattenfall - CFO

It was a second question as well?

Andreas Regnell - Vattenfall - Head of Strategic Development

Yeah, I think you maybe answered, can you also please break down the cash money receipts and payments on the Nordic market as opposed to outside the Nordic market? And I think you did or maybe you didn't?

Kerstin Ahlfont - Vattenfall - CFO

No, we gave the total.

Andreas Regnell - Vattenfall - Head of Strategic Development

Okay, yes. Any additional questions?

Oh, here comes one. From Jakob Magnussen, Danske Bank.

Jakob Magnussen - Danske Bank - Analyst

Clearly your leverage is way too strong compared to your target. Can you talk a bit more about what this will mean for your dividend and CapEx going forward?

Anna Borg - Vattenfall - CEO

Maybe I can start to comment that because as we said, there are a lot of one-off effects here. So I think it's important to distinguish between the result which is connected to the underlying business and there we see a fairly stable result, still strong financial ratios, which is what we should be able to show, but then more in line with the target range.

So the sort of increase of the ratios and the sort of overperformance in that sense, is mainly connected to these one-off effects and the temporary effects. So then we are back to the compensation for closing down nuclear in Germany from the German state. It's the sale of our electricity distribution business in Berlin and it's also the fair value, so the valuation of our financial derivatives, which will flow out again.

So I think it's important to distinguish between the two.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you. Any additions?

Kerstin Ahlfont - Vattenfall - CFO

No. I think it is important exactly as Anna said that you need to look at what is temporary effect, which will actually be reversed later on and what is not. So I think the owner will make its decision at the end and the policy is that we will dividend out between 40% and 70% if we are within our target ratios.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you. Let's see, Andrew is back.

Andrew Moulder - CreditSights - Analyst

You mentioned growth in floating wind. How long do you expect it to take before that will be an economic activity?

Anna Borg - Vattenfall - CEO

Well, so far, it's mainly on the development stage. We haven't built any floating wind yet, but we are participating in this tender process in France. And we are also in a tender process in Scotland about a floating project as well. So, so far, we don't have a project like that in our portfolio, but we're hoping to get one quite soon.

And then I think that it will still be a majority of sort of fixed bottom solutions for offshore wind for quite some time. But in the long run, we will see floating as well because it makes it possible to build wind farms at deeper waters where there's sometimes it's more wind as well.

So, so far, it's not in our portfolio. We are trying to get one or a few projects in because we think it will grow over time. And over time, it will definitely increase.

Maz Plechinger - EnergyWatch - Journalist

Just a fringe question regarding divestment. You booked SEK 124 million on a wind sale. Is this the 85.8-megawatt divestment to European Energy that was announced earlier this month? Also, is it possible to get an update on how Blakliden/FÅröbodberget is progressing?

Kerstin Ahlfont - Vattenfall - CFO

Well, that is indeed what we have booked. When it comes to Blakliden, Anna I don't know if you want to give a comment on that. But according to the information I have, that is progressing as planned.

Anna Borg - Vattenfall - CEO

It is progressing as planned. So that's yet another addition of fossil-free electricity to the Swedish energy system.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you. Next question on telephone. So question on telephone, please.

Operator

We have a question from the phone from the line of Philip Akoto from Energate. Please go ahead.

Philip Akoto - Energate - Analyst

Yes, thank you for having me. My question is about the retail market and the high prices as you mentioned here in Germany and then we have even bigger players that stop their new customer business, at least temporary or just took several actions. I would like to know how you deal with the situation since you've said you are expecting the prices to keeping on a high level?

Anna Borg - Vattenfall - CEO

Yes, and I think it's important to say a few things around that. First of all, of course, this price rally has an impact on our customers and for some, it's a very difficult situation. When it comes to the retail customers, many of them have a fixed price of their deliveries or a price that is linked to the market prices, but over a slightly longer period. So in many cases, it does not have a direct impact, but more an impact over time.

But still, we see a slower activity in the retail market. So not as many customers are turning or changing supplier as is usually the case. And some suppliers, especially smaller ones also have difficulties especially with the profitability. Because if customers are coming in and they have sold or they already have customers and they're selling to a fixed price, but they have not sourced all of that, then that sourcing cost will be very expensive now.

So I think we will see quite a bit of turmoil on the retail market also going forward. But the price increases will, in many cases come over time because there is a lag in many of the contracts.

Andreas Regnell - Vattenfall - Head of Strategic Development

Thank you. I have no more questions. Very good, then it's time for me to thank you all for attending. And welcome you back to our Q4 reporting events, the next exciting chapter on our journey. Thank you.

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