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Q1 2020 Vattenfall AB Earnings Call

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PRESENTATION

Karin Lepasoon *Vattenfall - Head of Communications*
Good morning and welcome to this presentation of Vattenfall's Q1 Report 2020.

This time, due to the current Corona situation, this is a combined audio cast and web cast. As usual, we will hear from our CEO, Magnus Hall and our CFO, Anna Borg, and after that, we will open up for questions. So with that, Magnus, I leave it to you.

Magnus Hall *Vattenfall - CEO*
Thank you very much Karin and good morning to everybody also from my side, and welcome to the Quarter 1 Results 2020 for Vattenfall.

Yes, I mean the situation right now is of course very much affected by what we all know, the pandemic scenario we have, and for us as a company, this also makes a big change in the way we need to operate, we need to make sure that we can handle our own situation with regard to continuity plans and make sure that we can deliver electricity and heat.

We will see additional pressure on the markets, supply chains, operations and customers. And we will just dig a little bit deeper into this as we go along, but to start with the quarterly result was stable in spite of clearly weakened market conditions, the underlying EBIT increased from 9.7 to 10.2.

If you remember, last year we had the Alfrida storm in quarter one, so more or less a stable result. But it's also significantly changing electricity prices during the period, resulting in lower earnings, both for nuclear and hydro. At the same time, we saw good contribution for our new wind capacity and strong winds at the same time.

We had good earnings in our sales operations, but we also had continued margin pressure in the fossil generation part of the company. So, the profit for the period increased by half a billion Swedish crowns to 6.9, mainly driven by a higher operating result and some one-off effect from the sale of nuclear production rights in Germany.

If we look to the dividend proposal, the Board of Directors revised it down from the previously announced 7.2 billion to 3.6. And that's of course due to the very uncertain market conditions we see ahead of us, and that was actually approved at the Annual General Meeting yesterday.

A little bit deeper into the current market situation, which is clearly changing, it's changing in two ways, if we look to the Nordic market where Vattenfall is quite exposed, we can see that we have three trends which are affecting, and it's more of a supply driven market deterioration there.

First, we have a lot of water in the system. If you look to the second graph there, this is depicting the water - how much hydro - how much water we have in the Nordic system. That's the dark blue part of the graph.

You could see that's now up on an all-time high, and at the same time you can see that market prices, spot prices, have been driven extremely low at the same time. And this is of course affecting us to the part that we are not hedged.

And if you look to the third graph, we can see that also prices for 2020 and the future prices are down 40% in the Nordics and 25% in the continental market versus the 2019 level. And if we look to the commodity prices, far to the right, we can also see that everything in the complex has decreased.

So, we have a supply driven market change in the Nordics. If we look at the first graph and we look at the demand, we can see that in the Nordics and in Sweden particularly, it was down, mainly driven by quite warm weather, but we now also expect of course with the lockdown following the pandemic, the fight against the pandemic, we expect that consumption of electricity will go down during the remaining of the year. Here are the first quarter figures, and January and February were not that much affected, but of course, if you go then into March and further into April, we believe that you will see more downturns in consumptions.

So a clearly changed market situation. And for us, it means that we need to fight this from various aspects, as I said earlier, to make sure that we have a health and safe - our employees are healthy and safe. We have been able to do that. We have a lot of people who work from home.

But we have also at the same time - of course the whole thing is aimed at limiting the spread of the disease and minimizing risk, but for us to make sure that we run our business in a safe and continued way, we have secured our business through continuation - continuity plans, which means that we are continuing to deliver in safe ways 24/7, heat and electricity and the services that we need to do.

This is very important for us, but we also believe, of course, in society that to have any disruption on these critical infrastructure parts will be significant negative situation, so for us, a very important part of what we are actually dealing with now.

At the same time, we have been trying to deal with a market situation, you can see that we have output - we have lowered our output at several nuclear reactors, the Ringhals number 1, which is about - which is to be closed at the end of this year. We have delayed the restart after the revision until sometime after summer in order to make sure that we can use the remaining fuel during a higher price period.

Then we have ongoing work of course, to align costs, that's the third part of our program. That's to make sure that we can find ourselves in a financially strong situation, adapting to the current market situation as we see going forward.

So, if you look to the quarter, the quarterly result was stable, but of course, a lot of the actions are now about securing the future and the way we deal with the situation in our company.

Now, we return back to the quarter one results, and you can see there that we had - net sales were more or less stable. And the underlying profit, as I talked about earlier, we - is slightly up on last year. I will go through in this a little bit more in detail. You can see to the right, the running 12 months, we have a return on capital employed of 9.4 and the FFO to adjusted net debt of 25.2.

If you go down the right and look at electricity production, if you want to highlight a few things there, we can see of course that the fossil power is going down due to the margins has significant decreased, nuclear power's down because we have closed also Ringhals 2 at the end of the year.

Hydro power is more or less the same as last year when we were running quite full. And you can see that wind power is now increasing, also helping us in terms of the results on the wind side.

I now go to the Customers & Solutions, which is our sales business, there we had improved earnings versus last year from 397 - mainly in underlying profit to roughly 1 billion. And of course, we here can see a strong contribution from our German side where we have increased the amount of customers.

And we are very happy about that, but we have - also have a lower depreciation in our Dutch business, which are customer contracts from the previous Nuon acquisition, they are now fully depreciated, so part of that is also depreciation reduction.

We sold our UK energy business to the French EDF electricity operating company. And we also sold our e-mobility services to Statkraft, because we felt that there was not enough momentum there for us to continue to grow, but at the same time we're pushing e-mobility, and we had - we have new cooperations here with Castrol in Germany and we do several different projects also to increase the green electricity sales - we have initiatives now launched in Germany to continue to increase that.

If you look just to the far right, you can see the charging points for electrical vehicles has quite significantly increased versus the first quarter last year from 11,800 to 16,500, and we continue to develop this charging - InCharge charging point system for our customers.

Power generation, which is mainly the hydro power and nuclear power in Sweden and our services business in Sweden, and of course also significant work to decommission our nuclear in Germany and also the pump hydro power in Germany - is where we are really exposed to the electricity price reduction.

And I talked earlier about the Nordic price situation, which is there, quite significantly changing the price. Even though we have hedged it, we see clear effects of the - of the current market situation, and the underlying profit went down from 5.4 billion last year to 4.5, and included in that is also a better trading result, so if you just look to the pure electricity production earnings, they are even lower than - that was even more lowered.

I think I mentioned the down regulation of nuclear reactors, and then we have also sold 11 TWh of nuclear power production - production rights in Germany, which was then part of the EBIT result, which was then quite significantly improved versus the first quarter last year.

And here, we can again, just see the two price graphs depicting the situations specifically dramatic in the Nordic where we have a very high hydrologic situation with the a lot of water and where prices are under significant pressure.

Wind is then improving the result, you can see from 1.5 billion versus up to 2.1 billion this year. Of course, we have added capacity and during the quarter, we had very strong winds, which were then also partly affecting the price situation in the Nordics, but that for us meant more production and a better result, so we are very happy with that.

As you know, we are now building our biggest offshore wind farm in the Kriegers Flak area which is in sort of right in the middle of the border between Denmark, Sweden and Germany in the Baltics, and we now just granted the final permit to continue with that project, and that looks very good.

We are - have another big construction in the Netherlands, it's continuing on schedule. It's a 300 megawatt Wieringermeer offshore - onshore wind farm complex. And then during the quarter, we have already communicated that we decided not to participate in the Hollandse Kust Noord tender process of 750 megawatt offshore wind power. And the reason is really that due to the uncertainties that we now see due to the Coronavirus situation, we have decided not to continue that process.

Then we are just also reflecting on a few things where we are doing in solar. We have a big solar project in the Netherlands, which has just started. We have the solar project in Sweden where we - we'll build one of the biggest solar projects.

And then, the last point here is that we just recently this week, announced that we are building a wind farm in the Scottish highlands - 240 megawatts together with Greencoat, a UK renewable energy investor, and they will acquire the wind farm, following its construction, so we will do the construction.

Then, the Heat side, there we can see that we are continuing our expansion of energy solutions. But we also see significant pressure here in the condensing business, because that is where we - where we have that, that's not - a big part of that is not part of the real heat business, but it's organized in there and puts pressure on the situation.

You can see that we went from 1.5 billion in underlying operating profit 0.9 billion. And we have had - of course, one change is that we have sold the Hamburg business, and another change is that we had quite a warm weather during the first quarter compared to - even it was warm last year, but it was even warmer this year.

And the current market situation, if you look to the right on the graph, you can see the spreads - with the clean dark spreads, which is the below figure - the light blue line here you could see it's clearly negative, which means that coal power is really not run very much in Europe at all right now. If anything, on the fossil side it's gas.

So, coal-fired power has really reduced its part of the energy mix, versus gas has actually increased. And the reason is of course, very, very low gas prices and even though the CO2 prices have gone up, they are now - they have been reduced during the last months a little bit, but it really means that the spreads are much better running gas production, and that's what we can see here in this graph.

We have been selected as a preferred energy partner for a development in Scotland. And it's a project called Midlothian, where we will use waste energy to build district heating.

And we also - we still had some operations in the Hamburg area, where we were part owner of a waste incineration plant, which we now have sold also to the - to the City of Hamburg, because it is part of their heating system - district heating system in Hamburg. We did that during this quarter.

So, under pressure when it comes to the development of the temperatures and the spreads, the margins that we actually earn in the condensing business puts pressure on the total heat side.

If we look to Distribution, there we had a - of course our significant problem last year which you can see in the service level - you can see here where we had breakage in the first quarter last year in Sweden, and that was really the Alfrida storm that cost us close to 800 million - around 800 million Swedish kronas, and you can see the difference in the underlying result going from 1.3 to 2.1 here, and the main difference is of course the storm costs that we had last year.

And if I want to highlight anything here, it's the continuing investment increase like we have. Now, we have a 44% increase in investment during the first quarter this year versus the first quarter last year, of course, when you have a storm like that, your investments sort of are postponed a little bit, so it's not - it's not the whole truth, but it is the direction we are running with increased investments also in the Swedish and the German grids.

And let's be clear about that, if we look to the Swedish situation when it comes to electrification and the future, the issue is not really to be much more production capacity of electricity, that we have enough of, what we really need to do here is to invest in the grids to make sure that we can deliver electricity to the places where it's needed.

We also made a big purchase during this quarter, to buy new smart meters. That means that we can measure much more often the electricity consumption. These are new regulations we are following, but we are now making that investment during the coming two to three years.

And then just a little bit extra, we have the contract now to be the largest battery storage facility in Uppsala in Sweden, and that's in order to make the local market more flexible. And this is - this is a trial that we are making and we will see if that can help us handle the local capacity constraints that we sometimes find due to the great constraints.

So, with that, having said that, I would like to turn it over to the financials and to our CFO Anna Borg. Anna, please?

Anna Borg ***Vattenfall - CFO***
Thank you. If we're going to deep dive a bit into the financials for the first quarter 2020, I would first like to point out that we see a decreased net sales of approximately 1.4 billion.

That is due to the lower prices in the market that you just seen, but it's also due to lower heat income due to the warm weather, the demand for both heat, electricity and gas has been lower compared to the same period last year.

Our underlying EBIT increased by half a billion SEK. That's due to several factors. We did not have any severe winter storms this year, as we had last year with the storm Alfrida that impacted especially our Distribution business.

We also have a growing wind portfolio, both in terms of more wind mills being built and being in production, but also due to more wind, so the wind mills are also producing more. We also see an improvement in our sales business. That is mainly related to our German market growth, but then we also have the dramatically lower electricity prices, and especially also the margin pressure in our fossil generation.

The profit for this period increased also by half a billion SEK and is now 6.9 billion. Apart from the higher operating result, we also have a one-off effect from sale of nuclear production rights in Germany.

And summarizing this into our financial KPIs our return on capital employed, which is supposed to be above 8% comes in at 9.4. Then it's important to state that this is a rolling-12 number, so we still have nine months from 2019 with us here and only three months from 2020.

The 9.4 is mainly a result of our higher gross margins, but also a capital gain from the divestment of the Hamburg district heating business and also the sale of the German nuclear production rights.

Our FFO to adjusted net debt, which is supposed to be somewhere between 22 and 27% comes in at 25.2. Apart from a higher FFO, we also see that we have positive effects from our hedging activities, again the sale of the German nuclear production rights, but also lower costs in our Distribution business and the increased capacity in Wind.

I think it's then important also to remember that for the full year 2019, we had an FFO to adjusted net debt of 26.5%, so it's then a bit lower now coming out of Q1 due to the market situation that we see.

Apart from the prices, it's also the Corona effect of course, although the Corona effect, is so far only seen in March, not in the entire Q1. So, I think we can anticipate further changes here going forward.

If we deep dive into the underlying EBIT, at each of our business units, in our Customers & Solutions business, we do see a strong contribution from the growth in the German market, maybe remember that last year, we had additional cost in the Customers & Solutions business in order to enable this growth and said that the profitability would be back short-term on those investments.

And that's what you see here in combination with lower depreciations in the Netherlands in the Customers & Solutions business this quarter compared to last. In our Power Generation business, we see lower achieved prices compared to the same period last year. That is also when you include the hedges.

We, to some extent, counteract that by higher earnings in our trading operations, but not fully. Again, we have additional wind capacity coming in and also stronger winds, which means that our business area Wind shows a strong result this year, compared to last.

In our Heat business, we see several things. First of all, we have sold the district heating operations in Hamburg and closed Hemweg 8, so both of these were in the numbers for Q1 2019, but are not there for Q1 2020.

Apart from that, we see the very low clean spark spreads and the extremely low clean dark spreads - also having an impact on the profitability, but also, of course means that we produce less electricity in the heat business.

On top of that, the heat sales has been lower this year, compared to last due to the warm weather. Finally, in our Distribution business, we have lower operating costs this quarter, compared to the same period last year. That is because we did not have a heavy winter storm this year, so last year, we have an impact of 800 million SEK in the Distribution business that is not there this year.

Looking at our cash flow development, you can see that we have a change in working capital, a decrease of 20.8 billion SEK. That is mainly due to three things, first of all, it's increased margin calls to exchanges, but also to OTC counterparts, that is to a large extent, mitigating the very large inflows we had in, for example, 2018.

On top of that, we have the seasonality effect that we see every year, that is the change in operating receivables and liabilities in the Customers & Solutions and Heat businesses. And on top of that, we have an increased stock of CO_2 emission allowances. We are to hand in those to the authorities in April, and that's why we have a stock that is slightly larger than usual.

In addition, we are making investments, both maintenance and replacement investments, but also growth investments. We continue to invest heavily in our renewable business. We also see increased investments in our electricity network business, and we also see quite a bit of investments in our nuclear business in order to make sure that operations can be up and running in a good way.

If we try and summarize our key figures, you can see that we do have a decreased net sales, we do have an increased EBITDA and EBIT, which is then due to slightly better operating results, but also due to these one-off effects of the sale of nuclear production rights in Germany.

Our underlying operating profit, which is a good way of measuring the actual performance in our operations is pretty stable, and so is the profit for the period. You can also see that we have generated less electricity compared to the same period last year, also sold less heat and less gas.

So again, our financial KPIs, the return on capital employed of 9.4% and the FFO to adjusted net debt of 25.2 shows a stable and good quarter, but then we have rolling-12 numbers here, so so far, only limited impact of the low prices this year, and also the limited effect of the Corona situation so far.

All in all, we can say that it's been a challenging quarter. Our hedges has to a large extent, contributed to the fact that we see the stability quarter versus quarter, the Covid 19 impact is only there in March so far, and the low electricity prices in continental Europe compared with the extremely low electricity prices in the Nordic market, plus the Corona impact is what is characterizing the results here and also going forward.

It's a tough situation, characterized by a lot of uncertainty, but also by a lot of action taken when it comes to prioritizing costs and investments in order to be able to maneuver in this new situation. And that is the summary of the financials for the first quarter of 2020.

QUESTIONS AND ANSWERS

Karin Lepasoon *Vattenfall - Head of Communications*

Thank you so much. It's time for the Q&A and we open up for questions. We have one question here on the web from Carlos Razuri from CreditSights in London, the question is would you say that the risk of delay in commissioning due to construction delays has increased due to the impact of Covid 19?

Magnus Hall *Vattenfall - CEO*

We haven't seen any of that yet ourselves. So, I think it's difficult to answer, but if you just take a general view on that, yes I think we should probably expect - and we are preparing ourselves to deal with possible delays during this time. But we don't have any significant delays to the actual situation, so let's see.

Karin Lepasoon *Vattenfall - Head of Communications*

All right. There are actually no questions on the telephone, and there are no further questions on the web either, so by this, we close this meeting.

Thank you very much for your attention.

Magnus Hall *Vattenfall - CEO*

Thank you.

Anna Borg *Vattenfall - CFO*

Thank you.
