

## Latvenergo Group Unaudited Results 6 months of 2018

Investor Conference Webinar Presentation

5 September 2018

Transcript

**Moderator:** Ladies and Gentlemen, good afternoon! Welcome to Latvenergo Investor Conference webinar about financial results of 6 months 2018. Today we are hosted by Latvenergo Chief Financial Officer Guntars Baļčūns. Before I give the floor to Mr. Baļčūns, a short reminder about the agenda of the webinar.

Firstly, we will have a presentation about Latvenergo Group activities and financials of first 6 months of 2018. Afterwards we will proceed with the questions and answers session. If you would like to use this unique opportunity to ask a question directly to the CFO of Latvenergo, please use the question box on the right side of your screen. All questions will be addressed after the presentation.

Mr. Baļčūns, I invite you to start the presentation!

**Guntars Baļčūns:** Thank you. Dear investors, dear stakeholders, good afternoon. My name is Guntars Baļčūns and I'm the CFO of *Latvenergo*. It's a pleasure to welcome you to our regular webinar introducing *Latvenergo* Group's results for the first half of 2018.

### ***Latvenergo Group Profile [slide 4]***

As usual, we'll start the presentation with a short introduction to the Group.

*Latvenergo* is a vertically integrated utility that operates in all three Baltic countries. It is wholly owned by the Republic of Latvia. Moody's credit rating for Latvenergo AS has been stable for several years and is at the Baa2 level with a stable future outlook.

Our energy generation portfolio consists of hydropower plants (HPPs) and highly efficient combined heat and power plants (CHPPs). We are one of the leading energy suppliers in the Baltics and one of the most environmentally friendly electricity producers in the European Union. In the first half of 2018, 63% or almost 2 TWh of electricity were generated from renewable energy sources.

In 2017 the strategic development and efficiency programme was initiated. It has left a positive impact on the results of the Latvenergo Group. The implementation of the efficiency programme has been more successful than initially expected. The programme provides for reducing the number of employees in the Group by around 1,000 by 2022. So far, we have already reduced number of employee by 600 or by 14%. At the moment around 3,500 employees work at the Latvenergo Group. The layoffs since 2017 represent almost 60% of the total planned workforce reduction.

Regarding changes in governance structure, I would like to mention, that starting from 25 September, a new member, Kaspars Cikmačs, will join the Management Board of Latvenergo

AS. We expect that Mr Cikmač's experience and competence will be a good addition in achieving the targets set in the Group Strategy.

### ***Market Overview [slide 6]***

Now, before we turn to a more detailed overview of our financial results, let me first highlight some of the key market factors and events that have affected our business performance.

The electricity price has risen not only in the Baltics but also in the Nordics. Electricity prices increased by 30% on average in all Nord Pool bidding areas compared to the first half of 2017. This was mainly driven by the warm, dry weather in Europe, which resulted in lower water levels at the Scandinavian hydropower reservoirs and lower output of hydroelectricity. In the first half of 2018, the average electricity price in the Latvian bidding area rose to 43.63 euros per MWh, which is an increase of 28% compared to last year.

Along with this increase, Latvenergo's role in the electricity market has grown. In response to the market situation, we've increased the output of electricity at the Riga CHPPs by 29%. We've been able to increase the Riga CHPPs' electricity output even at higher gas prices. In the first half of 2018, the natural gas price at the Gaspool and TTF trading platforms were on average 17% higher than in the respective period a year ago.

Another important issue that has affected our business results is related to mandatory procurement in Latvia. In late 2017, Latvenergo AS applied for a one-off compensation in the amount of 454 million euros from the state, agreeing to a 75% reduction of the support intensity for the Riga CHPPs. The compensation was divided into two parts: 140 million euros were to be recognized as other income in the profit and loss statement in 2017, while the remaining amount was to be recognized as income spread until the end of the support period in 2028. The Riga CHPPs' support buy-back has contributed to reducing the mandatory procurement fee by 3.11 euros per MWh, and as of July 1<sup>st</sup>, 2018, this fee is 22.68 euros per MWh.

### ***Revenue and Profitability [slide 7]***

Let's continue with the financial results of Latvenergo Group for the first half of 2018 on slide 7. In the first half of 2018, Latvenergo Group's revenue was 450.2 million euros. This is 6% less than the respective period a year ago. Meanwhile, EBITDA decreased by 12%, reaching 187.5 million euros. The results were negatively affected by the lower electricity output at the Daugava HPPs as well as by 75% lower support intensity for Riga CHPPs. Even so, the Group's profit in the first half of 2018 was 97.4 million euros, which is about the same as in the respective period a year ago.

Now, let's take a closer look at the performance of each of our business segments separately. On slide 8, we can see the generation and trade segment in more detail.

### ***Generation and Trade [slide 8]***

Generation and trade is the largest segment, making up 54% of the Group's EBITDA.

Like the *Latvenergo* Group results overall, this segment's results were negatively impacted by lower electricity output at the Daugava HPPs and by lower support intensity for Riga CHPPs.

In the first 6-month period of 2018, the electricity generated at Latvenergo Group's plants remained at the same level as a year ago. It was around 3,2 TWh. 63% of this was generated at the Daugava HPPs and 36% was generated at the CHPPs. Electricity output at the Daugava HPPs decreased by 12% due to lower water inflow in river Daugava.

However, electricity output at the Riga CHPPs increased by 29%. This increase is attributable to the Group's ability to respond effectively/quickly to higher electricity prices in the Nord Pool region due to decrease in the Nordic hydropower output and the warm, dry weather this summer.

In the first half of 2018, we have sold 3.3 TWh of electricity to customers in the Baltic countries. 1/3 of that was sold to customers outside Latvia. The total number of customers outside Latvia now reaches almost 35 thousand.

Last year, under the *Elektrum* brand we started gas trade to business customers in Latvia and Estonia. The total number of natural gas customers already exceeds 250.

We are also very pleased that we have started selling solar panels in all three Baltic countries and it must be said that there is a lot of interest in *Elektrum solar*. In total, 51 Elektrum solar contracts were signed.

### ***Distribution and Transmission [slide 9]***

Moving on to slide 9, let's take a look at the performance of the distribution and transmission segments. Both segments cover fully regulated businesses that are operated by Sadales tīkls AS un Latvijas elektriskie tīkli AS. Together they make up 43% of the Group's EBITDA.

The distribution segment makes up 32% of the Group's EBITDA. In the first half of 2018, this segment's revenue remained at the same level as a year ago, reaching 162.8 million euros. Meanwhile EBITDA decreased by 3%, reaching 59.5 million euros. The results were positively impacted by the 2% increase in the distributed electricity compared to the respective period a year ago.

Additionally, I would like to mention, that Sadales tīkls AS has an important role in the implementation of the efficiency programme. Within the framework of this programme, we are planning to reduce the number of employees at Sadales tīkls AS by around 800 in total by 2022. So far, the number of employees at Sadales tīkls AS has been reduced by 20% or 500. Besides that, the efficiency programme includes digitalization, process reviews, installation of smart meters, decrease of transportation units, and optimizing the number of real estate bases. At the same time, we have successfully continued our smart meter programme and so far we have already installed almost half a million smart meters.

Transmission segment makes up 11% of the Group's EBITDA. In terms of financial performance, this segment's revenues and EBITDA have decreased. The decrease is related to the lower cost of the capital rate set by the Regulator. In the first half of 2018, investments increased almost three times compared to the previous year, reaching 37.9 million euros. 32.4 million euros of this were invested in the *Kurzeme Ring* project.

### ***Investments [slide 10]***

On slide 10 we've summarized our investment figures. Capital expenditures have increased by 4% compared to the first half of 2017, reaching 96.6 million euros. 80% of investments are made in distribution and transmission segments.

Currently, the most active work is in the *Kurzeme Ring* project. This is an energy infrastructure project envisaging the construction of a 330 kV overhead high voltage power transmission line in the western part of Latvia. In the first 6-month period of 2018, 32.4 million euros were invested in this project. It is scheduled for completion by 2019, and the total planned construction costs are 220 million EUR. Around half of the costs are financed by EU funding.

Meanwhile, the Daugava HPP reconstruction programme imply reconstruction of 11 hydropower units. So far, we've invested 139.4 million euros in reconstruction. The programme is scheduled for completion by 2022.

### ***Funding [slide 11]***

Turning to the funding stats on slide 11, we can see that Latvenergo Group has a very balanced debt repayment schedule and diversified sources of financing. Total borrowings at the end of the first half of 2018 were almost 800 million euros, of which 17% were bonds.

In the reporting period, all the financial covenants set in the *Latvenergo* Group borrowing documentation were met. In May, dividends in the amount of 156 million euros were paid to the state, maintaining a good liquidity situation for the Group. As of June 30<sup>th</sup>, liquidity reserves are sufficient to implement the planned investment programme and fulfil the commitments according to the debt repayment schedule.

On March 14<sup>th</sup>, Moody's reconfirmed the credit rating of Latvenergo AS, which remains Baa2 with a stable outlook. I would also like to note that on June 15<sup>th</sup>, Moody's affirmed the green bond assessment of Latvenergo AS green bonds as GB1 (excellent), indicating the well-defined organizational structure and decision-making process for selecting eligible projects.

***Current Issues – Historically highest assessment in Sustainability Index of Latvia [slide 13]***

Now let's turn to current issues. This June, Latvenergo AS received the Platinum category of the Sustainability Index and the highest overall assessment – 97.2%. Assessment is performed by the Institute of Corporate Sustainability and Responsibility in Latvia, and the Platinum category is awarded to companies with a Sustainability Index over 90%. In the evaluation process, five areas are assessed. These are strategy, the environment, the working environment, market relations and society. We can see the result of the assessment of Latvenergo in these areas in the slide.

We have participated in the Sustainability Index since 2010, and 2018 was the 6<sup>th</sup> year in a row in which Latvenergo received the Platinum category. This reward clearly proves that sustainability is one of our priorities.

***Summary [slide 14]***

Before we start with the question and answer session, let me summarize the main points of the presentation.

The financial results were impacted by 75% lower support intensity for Riga CHPPs. In the first half of 2018, Latvenergo Group's revenue decreased by 6%, EBITDA decreased by 12%. Nonetheless, the Group's profit in the first half of 2018 was 97.4 million euros, which is about the same as in the respective period a year ago.

Electricity output at the Riga CHPPs increased by 29%. The increase is attributable to the Group's ability to respond effectively to electricity price increase in the Nord Pool region by producing the necessary amount of electricity.

In the first half of 2018, we continued to implement our efficiency programme. The implementation has been more successful than initially expected. Sadales tīkls AS has done extensive work in this regard through activities such as digitalization, process reviews, installation of smart meters, decreasing the number of transportation units, and optimizing the number of distribution real estate bases. So far we've already reduced the amount of employees at the Group by almost 600 since 2017, of which 500 represent layoffs at Sadales tīkls AS. The layoffs represent almost 60% of the planned workforce reduction, which we plan to fully implement by 2022.

That's all from my side. Let's now proceed with the question and answer session.

**Moderator:**

Mr. Baļčūns, thank you for the presentation. Now I will proceed with the questions in the order they were received. A reminder to those who haven't yet submitted their questions – you can do it in the “questions” section in the settings panel zone.

So, the first question is - what is the main reason for decreasing the number of employees? Are there any compensation to them?

- Guntars Baļčūns:** Thank you for the question. I will start that in the strategy we have put the ambition to work on efficiency, which is done in all our business segments. The main motivation for efficiency is to improve our financial results and to look for every opportunity to optimize our cost level.
- In case of reduction of employees there is a compensation according to the Collective Bargaining Agreement, that we have with the Labor Union.
- Moderator:** Thank you for the answer. So, the next question is - any more plans to improve efficiency of CHPP in the future, new investments etc.?
- Guntars Baļčūns:** Thank you for the question. I have to mention that our CHP plants are highly efficient and from technical perspective there are no other opportunities how to increase efficiency of these plants. They are at really good level at the moment already.
- Moderator:** Thank you for your answer. And the last question is – any funding plans and requirements for the remainder of 2018 and 2019?
- Guntars Baļčūns:** Also thank you for this question. At the moment we have not taken any decision regarding funding however in coming months we will definitely evaluate our funding needs for the next year and we will inform our lenders on our plans.
- Moderator:** Thank you for the answer and another question has been sent in - just in case you have been following, your view on Eesti Energia acquisition of Nelja Energija? What is your opinion on that?
- Guntars Baļčūns:** Thank you for the question. In this situation I would like not to comment this acquisition. I guess that wouldn't be correct from my side.
- Moderator:** Thank you. All the questions have been answered by now. Thank you Mr. Baļčūns for the presentation and for answers given. The recording of the webinar will be available in the Nasdaq Baltic youtube channel and in company's announcements. Participants, thank you for joining the webinar!
- Guntars Baļčūns:** Thank you and good-bye!

