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EDITED TRANSCRIPT

Q1 2021 Vattenfall AB Earnings Call

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PRESENTATION

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Welcome to Vattenfall and this Q1 reporting event and welcome back to our studio.

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

We are very much looking forward to sharing the Q1 financial results and major events with you, a strong quarter.

Anna Borg Vattenfall - President and CEO

And we will also give you an update on how we continue to take steps towards our long-term ambition to enable a fossil-free living within one generation.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

And as usual, we will open up for question after the initial presentation section and our standard slides are available on the web. But let's start by looking at the film overviewing our main achievements and events during Q1 2021.

Another eventful quarter, the energy industry is certainly a happening place. But before we go forward, Anna, you were invited to Joe Biden and the climate conference last week. What were your thoughts and reflections after that?

Anna Borg Vattenfall - President and CEO

Well, first of all, I think it's really good that the U.S. is back into the Paris Agreement, and that they clearly want to take a forefront position when it comes to taking action.

I think that Vattenfall was invited for two reasons. The first one is that our strategy to enable fossil-free living and the actions we take in relation to that is being noticed, but I also think it has to do with what is happening in Sweden.

There is an industry cluster emerging, especially in the northern part of Sweden around decarbonization of industries by electrification and I think that this also renders a lot of interest. And it was, of course,

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very nice to be able to convey that message.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Yeah, clearly a great opportunity to share some of the very positive things that are happening in Sweden. But now, the main financial achievements during the first quarter. Kerstin, the floor is yours.

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Thank you. Well, as I mentioned in the beginning, I'm very much looking forward to share the financial highlights. It was clearly a strong quarter with one major contributing factor being the significantly higher prices.

But if you compare it to the same quarter last year, the underlying operating profit reaches SEK12.1 billion and that is up with almost SEK1.9 billion, and the net result is up to SEK3.5 billion.

And if we look at our target ratios, FFO over adjusted net debt that is very strong and is at 32.8% whereas the rolling 12 months return on capital employed only stays at 5.9%. And that is negatively impacted mainly by the impairments of the mobile power plants, which we did in the second and the fourth quarter of last year.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Okay. So, a quarter clearly to be satisfied with. But if those were the financial achievements, what would you say were the strategic achievements during the quarter?

Anna Borg Vattenfall - President and CEO

Well, I think it's important to see the strategic achievements in a context. So maybe a few words about that first.

There is a dramatic transformation going on in Europe, in the energy production, in the transmission and distribution, the infrastructure of the energy, but also in the industry processes, an industry where you're working and I think that this puts a lot of demand on our industry.

We clearly see that there is a commitment with the Paris Agreement, for example, to reduce CO2 emissions. There is technology development going on pushing costs down, the CO2 price is increasing continuously and there is an increased customer demand for climate smarter solutions.

So I think our actions has to be put into that context. And maybe you can elaborate a bit on them, Andreas and give us the two minute version that explains it all.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Two minutes that explains it all. Thanks for that challenge. I think, yeah, I think it's quite, if you, if you take what you just said, and you take a few steps back and what is actually happening in the mindset, because I think that's where we need to start to explain things.

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I think that more and more stakeholders and business leaders are moving from a forecasting mindset to a backcasting mindset. And what do I mean with that? Forecasting is when you -- you're if you are a bit stuck in current realities, current policies, current business cases, and the next quarter result, if you want.

In the back casting, you start with what we have set out to do, to be climate neutral by 2050, and then you think about what is then necessary to do today. And the difference in what you come up with as a to do list if you want, is very different if you have a forecasting versus a back-casting perspective.

And more and more, these business leaders are realizing that the back casting -- and I think that's one of the things that actually were mentioned in the Joe Biden summit that to run early is a competitive advantage and more and more people see that.

And when it's an industry or a significant part of an industry moves from forecasting to backcasting, something happens. And I think one example of that is the oil majors and what has happened with the offshore industry where, where a significant number of oil majors say we need to move into electricity, it has major financial effects.

And one of the common denominators of course for that for Vattenfall is that the demand for fossil-free electricity goes up in many of those switches or catch-up effects if you want. Another thing that happens is that we will see more growth opportunities than we can possibly master ourselves.

So prioritization will be very, very key for us, but we will get back to that. So that was my two minutes. So now back to you, Anna. What were our strategic achievements during Q1?

Anna Borg Vattenfall - President and CEO

Excellent summary, by the way, and I also think that it describes how important it is that Vattenfall has this forefront position that we do. We are one of the leaders when it comes to building renewable electricity production, for example and that's also one of the areas where we are progressing.

We are in full swing, building Hollandse Kust Zuid, the world's largest offshore wind park outside the coast of the Netherlands.

We're also constructing Kriegers Flak in Denmark. The first turbine was up and spinning in January and now more than half of the turbines are up and we are actually producing already while we are constructing the remaining part of the wind park and it will be finalized later this year.

We are building and rebuilding our heat networks and heat infrastructure. So for example, the Amsterdam South Connection is now in forward mode that we are building there. That will enable more than 300,000 homes to connect to the heat grid in that area over the next few decades, so that's a big step forward.

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And we are also starting the building of the Brent Cross South in London, which is our stepping-stone into district heating in UK.

We continue to increase our investments in the distribution almost day by day, there is an increasing demand for connecting new capacity, mainly wind parks but also new customer demand either by new companies or by existing customers wanting to increase their electricity consumption.

And then we also enable our customers to be climate smart in their businesses. We actually grow a lot in Germany. We have more than 4 million customers there now and we continue to grow so that's very, very good.

We continue to grow our charging infrastructure for electric cars. And we also took the next important step together with SSAB and LKAB and decided to go on with a demonstration plant of HYBRIT in Gallivare.

So we still have a lot of things to do in Vattenfall. We are not done but we know where we are heading and we are getting there step by step.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

I think it's hard not to say, wow, that was just one quarter of strategic achievements, things are happening very fast. But back to you Kerstin and dig a bit deeper into the financial results, why did we have such a strong first quarter?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Well, if we look at the drivers for the good performance in the first quarter, I mean, I mentioned already in the beginning the significantly higher prices.

And to take just one example, which is also the most important for, specifically, our portfolio, the average Nordic spot prices were up 173% compared to the quarter the year before. And although it's not impacting our income statement as dramatically because we are hedged, it still shows a clear positive impact.

And then we were also able to have good availability both in our hydropower plants and in our nuclear power plants. So this quarter, we really were able to capture these favorable prices. And that, together with a good trading result made the operating segment Power Generation move up SEK1.8 billion in underlying operating profit compared to 2020.

We also have a better result in our Heat segment mainly related to the decommissioning of the Moorborg power plant. So, we have lower costs, and lower depreciation. In the Customers & Solutions, as Anna also mentioned already, we continue growing our B2C customer base and we also had higher volumes this quarter due to the colder weather.

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We see a bit of a sort of change in the opposite direction in Wind, due to lower wind speeds in the quarter, and also somewhat lower availability. And maybe to mention two more things, we have the sale of the nuclear production rights in Krummel. We sold more in January and that is also reflected in the results in items affecting comparability. And finally, also a good return on the Swedish nuclear waste fund coming from the increasing -- the positive development in the stock market and that also has a positive impact on the net result.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

So quite a number of things going in this -- in the right direction. And how did that translate into cash flows?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Well, if you look at the cash flows in the quarter, we have a strong operating cash flow from the business. We have some negative seasonal effects from our Heat business and Customers & Solutions.

So the operating cash flow is SEK11.1 billion in the quarter and that carries well our investments with a healthy margin, I would say. And then the cash flow before financing activities is SEK5.7 billion.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

You mentioned previously in the main of the achievements, that they have FFO to adjust net debt ratio for the quarter is as high as 32.8%. That's really high. Anything you want to say about that?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Well it is. It is quite high, I agree on that and if we compare this metric with one quarter ago, so end of 2020, we see an increase in the funds from operations due to the strong cash flows in the first quarter this year, compared to the first quarter last year.

But also contributing to this metric is the decrease in adjusted net debt. And if you look at the slide and see how that developed during this first quarter, you can see that the adjusted net debt decreases with SEK9.3 billion. And again, it is the strong operating cash flows from the business that is the main contributing factor.

But we also see higher discount rates impacting our pension provisions and also as I said earlier, the better results from the Swedish nuclear waste fund. So all in all, our net provisions are decreased with SEK4.5 billion and counter balancing that a bit are then some currency effects.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

I can't leave this FFO to adjust the debt ratio, really, it's clearly above our target range of 22% to 27%. Do you expect that to stay at that level?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

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Well, Andreas we do not give any forecasts on that, but I think it's fair to say that to some extent, this is driven by temporary factors like improved cash flows from margin calls, decrease in pension provisions and also not to forget these numbers do not yet reflect the dividend that relates to the results from 2020, SEK4 billion.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Okay, that's clear then. And Anna when we were here in February reporting on the 2020 results, I asked you and Kerstin for the two words that you thought best characterized Vattenfall during the year, and you picked progress and resilience at that time. If you sit here today, do you still think that's two good words to describe and characterize Vattenfall?

Anna Borg Vattenfall - President and CEO

I think it is, in relation to what's happening now, but also in relation to what should be expected. I mean, last quarter, the first quarter last year, we had a bit of, a bit of headwind, it was record low prices.

And this year, the first quarter, we have a bit of tailwind instead and we see an improved performance, maybe not as much as you would think just looking at the price development.

But then it's also important to remember that we have a lot of our electricity production in the Nordics and the prices have for the reasons that you also talked about not increased as much there.

So I think that, yes, progress and resilience are still good words when it comes to our business, but also our result. And it is, of course, very nice that we were able to give a dividend to our owner this year again.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Yes, thank you. Financials, main financials, but are there anything else that we should mention, do you think?

Anna Borg Vattenfall - President and CEO

I think there are a lot of things going on. But maybe two things specifically, during the first quarter that are worth mentioning is, first of all, the agreement with the German state regarding compensation for close-down of nuclear.

That will hopefully end many years of legal disputes over this. We will receive 1.4 billion euros in compensation. And although this is an agreement now has to be passed into law in the German Bundestag, and that will happen later this year, so that still remains.

A second topic is the verdict in the Administrative Court regarding the regulation for the distribution business in Sweden, where the ruling was, as we expected, that the proposed regulatory setup is not in line with the Swedish and EU frameworks.

Now, that is, however appealed. So the regulator will now have to present the reasons for appealing, but I do hope that we soon can also end this legal process and continue to focus on what needs to be done instead.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Sounds like a very good objective, but some tailwind also on the legal side this quarter. Kerstin, same question to you, is there anything that we forgot to mention that we should?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Oh I think most things have already been mentioned, but maybe I can add two things. We had the sale of the wind farm Gronhult this quarter, and parts of our wind business will in the future focus more on the value creation in the development process.

And Gronhult was one of our first projects which we actually developed in order to sell and we are quite happy I think with the outcome there. And another item is maybe the -- that we were able to win our largest contract so far in the UK as an IDNO, an Independent Distribution Network Operator.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

I just realized that maybe we should mention one more thing. And that's the decision we received last Tuesday from the Berlin Senate on the Stromnetz Berlin. Maybe you want to say something there?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Yeah, exactly. The senate took a decision earlier this week and I think that shows that they share our valuation of the company, roughly 2 billion euros. And the next step now is that we need to have a parliamentary decision and the law passed through there. And we expect that to happen early summer, I would say.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Thank you. And before we end this discussion, Anna, I think we're quite happy with how we progressing and even leading the development in some areas, but at the same time, we realize that we are facing investment opportunities and growth opportunities beyond what we can master ourselves, so we need to prioritize. How are you thinking about that need to prioritize?

Anna Borg Vattenfall - President and CEO

Well, that need is definitely there and it will always be there to make sure that we can deliver on growth ambitions that actually create value, but also on our financial ratios, so it will continue to be to be important.

I think that the decisions we make today will determine what kind of company we are tomorrow. So it's important to make the prioritization based on our competitive advantages and the ones that we think will be there or we will make sure are there also long-term going forward.

So this is a central discussion in the leadership team of Vattenfall and it will continue to be. There would be some clarity needed, I think on a couple of long-term prerequisites in the Nordics but maybe also specifically in Europe, and that is what kind of electricity or energy production will be acceptable in this transformation, now.

There are lot of discussions going around in relation to taxonomy, biomass, for example, and the investments that we and others make are large investments and they need to be there for a long time. So that kind of clarity would for sure be welcome. But focus and prioritization will be key for us also going forward.

QUESTIONS AND ANSWERS

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

That's important for us all. Thank you. And that actually concludes what we plan to present today. And now it's time for Q&A.

So, as usual, we will take questions, both from the web and on the phone. And let's see here I have the first question from Andrew Moulder.

Andrew Moulder CreditSights - Analyst

You mentioned building heat infrastructure. Fortum is considering the sale of its stake in Stockholm Exergi. Is that something you would potentially be interested in?

Anna Borg Vattenfall - President and CEO

Well we have -- actually, now signed a NDA in relation to that transaction and process, so when we cannot comment on that at the moment.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Okay. Thank you. Next question from Petra Sorge, Dow Jones news.

Petra Sorge Dow Jones News - Reporter

The city of Berlin stated that they will buy back the electricity network for 1. -- 2.143 billion euros from Vattenfall. Can you confirm this sum?

How satisfied are you with this result and is it -- as it is clearly below earlier estimations that it even went up to 2.4 billion euros? Also, are you considering any change of the district heating business in Berlin?

Kerstin Ahlfont Vattenfall - Senior Vice President and Chief Financial Officer

Well, we can confirm that number and we are happy with that valuation, that is also what we proposed, so that is confirmed. And the other question was regarding the district heating business, we have made no decisions on that that is part of our core business going forward.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

That means I see no more questions on the web. So let's go for a question from the phone.

Operator

There are no questions from the telephone.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

No questions from the phone. Then we get two more questions from Andrew Moulder.

Andrew Moulder CreditSights - Analyst

Maybe we start them later

Do you have a view on whether gas and nuclear should be included in the EU taxonomy for sustainable activities?

You mentioned the need to be selective with your growth opportunities and you also said the oil majors are all moving into electricity and we have seen them doing that in an aggressive way in renewables.

Do you still think renewables should be your key investment area or are you looking for focus more on heat, customer services and hydrogen? I think there was essentially two questions here. Yes.

Anna Borg Vattenfall - President and CEO

Maybe we start them later one on where Vattenfall will focus and the increased competition in renewables.

It is true that there is an increased competition in renewables. There is also an increased demand, I would say, with the increased ambitions and now implementation of Paris Agreement levels in many of the countries in Europe.

We have a clear competitive advantage and we are one of the leading players in renewables, especially offshore wind, and we will continue to be there.

We are, however, an integrated energy company and that is serving us well in a situation like this, because we are striving to have a balance in our portfolio in order to also be able to carry the risk it means when for example, building merchant exposed to offshore wind.

But the competition is for sure increasing, but that also provides opportunities for partnerships in different dimensions. So I think there will continue to be a lot of focus on this also for Vattenfall.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Good if you then would take the first part of the question, do you have a view on where the gas and nuclear should be included in the EU taxonomy for sustainable activities?

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Anna Borg Vattenfall - President and CEO

Well, right now it's lifted out of the taxonomy and to be discussed further. And it has also rendered a lot of discussion in Europe, of course. So for now, it looks like it's not in there, but it is to be determined.

I think that especially gas will play an important sort of bridging role in Europe when phasing out coal. So the situation will also look different in different parts of Europe and that probably makes this even more complex.

So it's too early to say if it will be there to some extent and for how long, so we will have to wait a bit and see how that plays out.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Thank you. Question from Alice Stretch.

Alice Stretch Baillie Gifford – Investment Manager

Can you share more on PPAs or other wind partnerships and your ambition in that area going forward?

Anna Borg Vattenfall - President and CEO

Well we have clearly said that we will look for partnerships in some of the projects that we are building or plan on building, so that we are.

And then we're looking for quite large partners and that's also partnerships that will prevail over time. Then we have the PPAs which is more related to the offtake of some of the renewables and there we see a large interest.

The market is not very standardized yet and that also makes this not move forward maybe in the pace that it could in Europe, but we're definitely going to do that as well. And we mentioned one of them, today, a 15 year one with Air Liquide in relation to Hollandse Kust Zuid and was there a third element of the question?

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

No, I think more on PPAs or other wind partnerships and your ambition in that area going forward. I think you covered it pretty well. No more questions on the web. No questions on the phone.

Operator

There are no questions on the phone.

Andreas Regnell Vattenfall - Senior Vice President and Head of Strategic Development

Okay, that I think then concludes, also our Q&A session and the session for today. So thank you all that listened in and we wish you a warm welcome back for our Q2 reporting.

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