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Q3 2023 Vattenfall AB Earnings Call

EVENT DATE/TIME: OCTOBER 26, 2023 / 7:30AM GMT

## CORPORATE PARTICIPANTS

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**Anna Borg** *Vattenfall AB - CEO & President*

**Kerstin Ahlfont** *Vattenfall AB - Senior VP & CFO*

## PRESENTATION

**Andreas Regnell** *Vattenfall AB - Senior VP & Head of Strategic Development*

Good morning, and welcome to Vattenfall and this Q3 reporting event. I'm Andreas Regnell and with me in the studio, I have as always Anna Borg, our CEO; and Kerstin Ahlfont, our CFO.

Today, we will go through the main aspect of our financial performance and the key events during the period. After the initial discussion, we will allow for questions on the phone and on the web. And as usual, the Q3 slide material is available on our website. But let's begin, Anna, another exciting quarter in our industry has passed. What would you like to mention?

**Anna Borg** *Vattenfall AB - CEO & President*

Well, I think there's a lot of things going on. And 3 things worth mentioning is that we have now inaugurated our offshore wind farm, Hollandse Kust South outside the Netherlands, that's our largest offshore wind farm to-date. We have also seen an improved result in our heat business. And that we have also decided to move on and investigate further when it comes to new nuclear in Sweden, which I would like to mention something about.

**Andreas Regnell** *Vattenfall AB - Senior VP & Head of Strategic Development*

We'll get back to that. Yes. Kerstin, how's the financial development been?

**Kerstin Ahlfont** *Vattenfall AB - Senior VP & CFO*

Well, the reported underlying EBIT for the first 9 months declined and we also report a lower profit for the period and this result development is to a large extent connected to lower electricity prices, which we will come back to later on. And if we look at the single quarter, here, the impact from lower electricity prices is even more prominent, and therefore we reported a loss.

**Andreas Regnell** *Vattenfall AB - Senior VP & Head of Strategic Development*

We will get back to the financial performance, but before we do that, can you please elaborate a bit more on the main things you mentioned about the wind business?

**Anna Borg** *Vattenfall AB - CEO & President*

Yes, of course. We are very proud that we have now inaugurated Hollandse Kust South outside the Netherlands. It is the largest offshore wind farm to-date. It's also built without subsidies. And it will actually be able to supply 1.5 million Dutch households with electricity. So we're very happy about that. We had the inauguration in the presence of the Dutch King and also together with our partners in the project, BASF and Allianz and it's a key milestone for us, so we're happy for that.

I'd also like to mention that we decided to use the option that we had in order to go ahead with the Nordlicht II project, which is offshore wind outside Germany, that is adjacent to Nordlicht I, which we already are developing, so it's a zone and altogether that will be able to provide 1.7 million German households with electricity. We've not made the investment decisions yet. But they could be up and running in 2027 and 2028.

**Andreas Regnell** *Vattenfall AB - Senior VP & Head of Strategic Development*

Clearly positive and -- but in that context, in the Q2 report we talked a lot about the challenging environment in the offshore wind business. And that led to our decision to stop the Boreas project. How are these -- the situation different here?

**Anna Borg** *Vattenfall AB - CEO & President*

It's very different then in many ways, I would say. The Norfolk Boreas project had a fixed income, revenue in a CfD which was set before the turmoil in the energy market while we've then seen the cost increase up to 40%, both due to inflation and increased capital costs. So

we knew that if we would have made that investment decision, we would have locked in a project which was not profitable enough. And that is simply not prudent. So we don't do that.

It's very different in the Nordlicht projects in Germany, because they are being developed now in a different market environment, where both the price level and the cost level is different. So they are differing in many, many ways.

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**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Okay. Very clear. Is there any news when it comes to the Norfolk projects?

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**Anna Borg Vattenfall AB - CEO & President**

Well, we are looking into all possible options when it comes to how to develop this zone because it's actually 3 projects, not only the Boreas one. And we know that this zone is very important to U.K. and to the fossil-free energy production that is needed to be added there. So we're looking into all options, but we haven't made any decisions yet.

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**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Okay. Thanks for that. Let's focus on the electricity market. How has development been there?

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**Anna Borg Vattenfall AB - CEO & President**

Well, we have seen significantly lower prices this year compared to last. I mean, if you look at the spot price this year, it's a decline with approximately 60% during the first 9 months compared to last year. So that is a huge decline. And we can see that the prices in the Nordics have been affected to a large extent by wet weather, but also by a strengthened hydro balance.

In the continental Europe, it's mainly connected to the price of gas and coal. But we also see very well filled gas storages in Europe that has an impact downwards. And we also see that the French nuclear is up and running to a much larger extent than was the case last year. So I think it's important to remember that approximately exactly 1 year ago we saw the peak in the energy prices in Europe and now we see record low prices. So the difference quarter-to-quarter is even more substantial, which is also visible in the results of course, so record low prices for the moment, record high prices a year ago.

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**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Yes. And I guess, we see that also in the futures market.

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**Anna Borg Vattenfall AB - CEO & President**

Absolutely.

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**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

So very volatile overall, but in these times more in the low side than the high side. How has that impacted our performance, Kerstin?

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**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

Well, the development that Anna just described has had a negative impact on our financial results. So the reported underlying EBIT for the first 9 months stood at SEK 15.5 billion, a decline of SEK 7 billion and this is offset by our Nordic price hedges, which in combination with a positive impact from lower price area differences in the Nordics market actually led to an increased achieved price in the third quarter.

On the contrary, we saw lower prices that led to a negative result from our hedges on the continent which were less efficient than in the Nordics. If we then move on to the profit for the period, that amounts to SEK 4.7 billion, which is corresponding to a decline of SEK 12.2 billion. And in addition then to the decline in the underlying EBIT, we also have the impact from the impairment and provision of the Norfolk offshore wind park that we did in the second quarter last year, which amounted to minus SEK 5.5 billion.

And then it's also important to remember that the profit that we had in 2022, was to a large extent also impacted by positive valuations of electricity and fuel contracts, following the very high prices we saw in the third quarter last year.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

You also mentioned that we reported a loss for the single quarter. Probably that's worth deep-diving a bit into, I think.

**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

Yes, that is correct. We reported a loss of SEK 2.2 billion and the underlying operating profit declined to SEK 900 million and here we see the impact from the lower electricity prices on our generation portfolio. But we also see a negative impact on fair values from energy derivatives, where we saw sort of a significant positive effect in the same quarter last year.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you for that. And we will dig a bit deeper into the performance of our operating segments. But let's talk about our main financial targets. And we reported a negative return on capital employed, didn't we?

**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

Yes. So the return on capital employed amounted to minus 4.6%. And this is a ratio that is based on rolling 12 months. So that is important to say because that means that we still have the impact from the negative fair values of energy derivatives that we saw in the fourth quarter last year in that number. You remember that we had this as Anna said, the very high prices in the third quarter where we had lots of uncertainty and the markets experienced extreme volatility.

And then prices dropped significantly in the fourth quarter, because it was warmer weather and there was less concern for the gas shortages and that led to a negative impact from fair values of energy derivatives in our Q4 results, but if you look at this from -- on an underlying basis, return on capital employed amounts to 9.8%. And then if you look at our capital structure, that remains on a good level, so FFO over adjusted net debt, rolling 12 months is 30.9%. So that is slightly above our target ratio 22% to 27%.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. And let's now go to the operating segments. How does the performance there look?

**Anna Borg Vattenfall AB - CEO & President**

Well, if we look at our Customers & Solutions business, we actually see an increased contribution compared to last year and that goes for our heat business as well. More customers choose Vattenfall, which we are of course very happy about and we now have more than 11 million customers. The heat business has showed a significant improvement. It's mainly due to price adjustments for heating in Berlin and in the Netherlands. And that compensates for the increased costs we saw last year when it comes to fuel.

Another good development is that we have taken investment decisions in order to decarbonize the heat portfolio. That includes, for example, integration of excess heat from third parties in Berlin. It's also important to mention, although that was after the closing of the quarter, that we have signed a memorandum of understanding with the state of Berlin when it comes to holding exclusive negotiations around the potential sale of our heat business in Berlin. We still expect a decision later this year. And I see this is a good step forward.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. But how about the Wind and Power Generation operating segments where most of the electricity generation happens?

**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

Yes, and this is where we see a declining contribution since these are exactly as you say, the segments which are impacted by the lower electricity prices, but we also see a negative contribution from lower generation volumes. We have lower volumes from our hydro power mainly due to asset optimization in relation to the power price development. But we also have lower volumes from our nuclear power and that is mainly due to the prolonged outage that we had in our Ringhals unit 4 in the first quarter this year.

And the Power Generation that is also as you know, the segment where we report our group-wide hedges and they have a positive contribution when it comes to the Nordic hedges, but we see a negative contribution from the continental hedges, but we also see an offsetting effect from a fairly strong trading result as well. And if you then move on to the wind business, there we actually see a positive development when it comes to generation volumes. It's increasing with 10% since we now have Hollandse Kust South operational.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

And something on the electricity distribution, perhaps just a few words.

**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

Yes. Absolutely. When it comes to our distribution operations, they show actually a stable development and underlying operating profit for the first 9 months is actually increasing slightly.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

So good news there. Anything else that we should mention?

**Anna Borg Vattenfall AB - CEO & President**

Well, I'd like to talk about the progress when it comes to new nuclear in Sweden. As we've said before, nuclear will play an important and vital role when it comes to fossil-free electricity production in Sweden, but also in the world in general. And we are in the middle of the work regarding the feasibility study for new nuclear at the Ringhals site.

We are now preparing for public consultation, which is the next step in the process that you need to do. That also includes making sure that we can evaluate how to use the land in the best way and we are actually also acquiring land adjacent to what we have today to make sure that there is enough space for what we eventually would like to do.

We are evaluating the proposals from the suppliers that we have received and we are also preparing the permit applications including the environmental permit that is needed. And I think that it's important to understand all of these prerequisites in order to be able to run this in a good way. I would also like to mention that I've travelled around together with some of the colleagues from the executive group management in Vattenfall to visit the projects that where new nuclear is being built or recently have been built in order to make sure that we take all the experiences and learnings from those projects with us into development of new nuclear in Sweden and make sure that that has the prerequisites to develop in a efficient way and as fast as possible.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you for that. And with that, we come to the Q&A session. But before we let the questions loose, I'd like to remind you all about the upcoming Capital Markets Day on November 28, where we will give you a perspective on our view of the market, is the market stalling? But also how we act in this market situation and you will also have the opportunity to ask questions to all of executive group management. With that, over to Q&A.

**QUESTIONS AND ANSWERS**

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Welcome back to the Q&A session. Our first question comes from Andrew Moulder. There was some speculation that you might be trying to sell on the Boreas project. Is this something you would consider and have you seen any interest from potential buyers? Could you talk about what other options you are considering for Boreas? Could you just wait and try to bid into a future CfD auction?

**Anna Borg Vattenfall AB - CEO & President**

Well, that is of course one option. And as I said we are looking into all available options. We're not excluding anything. We are continuing the work with the projects and we know how important they are in the U.K. context. We also know that offshore wind will be a major piece of the puzzle in order to provide the electricity needed in Europe going forward.

We have not decided what to do with the projects or if it's us that's going to do something with the project or not. So we are evaluating all different options. But I think that we share the concern with all our peers in the industry about the situation we see right now where the CfD levels offered are simply not enough in order to make their projects profitable with the cost levels that we see now. So this squeeze in the market and in the supply chain, in addition to that makes these projects very, very challenging for the moment. But again, we have not made any decisions and we are evaluating all options.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. Another question from Andrew Moulder. On new nuclear, any thoughts about how this would be financed? Would it be down to Vattenfall, or would you expect some kind of state-backed finance?

**Anna Borg Vattenfall AB - CEO & President**

Well, we are still in the middle of the analysis when it comes to new nuclear. And as I said, we visited all the projects that have been built recently in Europe, but also a few of them around the world. And I think some common learnings from those are that these are long-term projects with high risks. So financing is going to be very important because that's one of the main risk components.

And we can see that in all countries where new nuclear is being built, there is some kind of risk sharing between the state and the actors in the market. But we are not there yet in relation to what this actually means for our projects going forward. What I would like to emphasize is that we are working on a commercial basis. So we will only make investments if they are profitable enough in order to meet return requirements set on us by our owner.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

I think the next question also comes from Andrew Moulder and I think you answered it, but I'll just read it out anyways. Would you expect some kind of CfD or PPA for new nuclear?

**Anna Borg Vattenfall AB - CEO & President**

I think we have seen a couple of examples like that that are really interesting in the U.K., for example, where there's been a CfD in place for new nuclear and now there is a regulated asset base model in place for the next one. So I think with the amount of fossil-free electricity needed in Europe going forward, I think that there are going to be a need for incentives for offshore wind, for nuclear or other fossil-free energy production in order for this to happen fast enough.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. Then we go to Matas Kadusauskas from Covalis Capital. Could you please provide and comment on how are German retail margins developing or can you at least confirm that they are improving versus Q1, Q2 '23?

**Anna Borg Vattenfall AB - CEO & President**

Well, we are not commenting on our sales margins, of course, for competitive reasons, but what we can say is that we are attracting more customers than before. And we also see a increased performance in our sales business in general, not only over a certain period in time, but over a longer period of time. So I take that as a sign that we are providing products and services to our customers, which is valuable to them and therefore we are also able to conduct an efficient business and a good margin.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. Jakob Magnussen. Two questions. So in spite of higher achieved power prices in the Nordics, the net effect of lower spot prices outside the Nordic means that the group-wide achieved power prices is in negative for underlying EBITDA. Should I read it again? Because I didn't understand the question completely myself. So in spite of higher achieved power price in the Nordics, the net effect of lower spot prices outside the Nordics means that the group-wide achieved power prices is negative for underlying EBITDA?

**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

Yes, I mean, it is correct that we have an increase achieved price in the Nordics as I mentioned and that is due to our Nordic price hedges and also that we see in this year lower price area differences in the Nordic market compared to earlier, but then we have lower prices that is affecting spot price that is affecting the continent and then our continental hedges have not been as efficient, so there we have a negative contribution. So all in all, it is a negative impact on the EBITDA.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. Second question. Do you see a risk of Sweden setting up a separate nuclear operator as proposed by Mr Åkesson?

**Anna Borg Vattenfall AB - CEO & President**

I can't comment on that. That's a comment for the government or a question for the government, I think.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Now comes Maz Plechinger from EnergyWatch, 2 questions. How certain are you that Vesterhav Syd and Nord will be fully grid connected by December 31? And what will be the consequence if they're not regarding the profitability and/or other consequences?

**Kerstin Ahlfont Vattenfall AB - Senior VP & CFO**

When it comes to these 2 projects, it is our plan to have them connected by the 31st of December this year and we are sort of confident that that will also happen. If that would not be the case, then of course, we will not be able to produce and deliver electricity which would have a negative impact of course on our results.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. Second question from Maz. Vattenfall project was snubbed in the Danish so-called "Open Door" scheme earlier this year. Is this matter all in the past for you, or are you pondering further steps, i.e., legal action?

**Anna Borg Vattenfall AB - CEO & President**

Well, we have to wait and see where this goes. I think in general it's very unfortunate that the sort of frameworks and prerequisites are changing on the way. And I also think that with the increased need of more fossil-free electricity in Europe, I think it's probably wise to see how more projects can be developed faster, rather than thinking about more government intervention in them. So I'm not very happy about that development, but we haven't decided exactly how to move forward.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. [John Meyerson, BR Finance]. How is the French market developing? Any news about hydro?

**Anna Borg Vattenfall AB - CEO & President**

I'm not sure if the question relates to the French market in general, or if it relates to Vattenfall's activities in France. But I mean, we can see that this year the French nuclear is up and running to a larger extent than what was the case last year, which is the majority of the production fleet in France, although there is of course hydropower as well. So that has a sort of downward pressure on the prices in Europe in general, I would say.

When it comes to Vattenfall's operations in France, we have a sales business there and we've been there for 20 years with our sales business. As you probably know, we've also tried to enter the offshore wind space, but we have not succeeded so far. And we don't have any hydro power operations in France and we're also not exploring any sort of acquisitions or otherwise in relation to hydro power in France, if that's what the question relates to.

**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. Okay. Samu Wilhelmsson, Nordea Markets. You seem confident that the new offtake prices in the new projects should make the projects in offshore wind profitable and we wouldn't see further cancellations on projects from your side. What kind of risk do you see for that? For example, if fixed offtake prices wouldn't adapt and why? And how these could be tackled?

**Anna Borg Vattenfall AB - CEO & President**

I think maybe there are 2 questions in one here because first of all, I am concerned about the development when it comes to offshore wind in Europe in general, because I think in the countries where we've seen a CfD scheme that has simply not been good enough in order to motivate the further development of projects.

In the markets where we've seen other auctioning mechanisms, like recently in Germany for a couple of projects, for example, where Vattenfall decided not to participate, because the main differentiating factor where how much you were prepared to pay to get the projects. And we think it's important now to secure the profitability of offshore wind projects in Europe and make sure they are actually built because if the power is not there in the end, it really doesn't matter what kind of pricing mechanism you use. So it's about making

sure that these projects can be developed going forward. And again, we will evaluate each and every project on its own premises, and they differ from country to country. And we will only make the investment decisions if the profitability is good enough.

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**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

Thank you. I think there was no more questions there. Do we have a question on the phone?

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**Unidentified Company Representative**

No.

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**Andreas Regnell Vattenfall AB - Senior VP & Head of Strategic Development**

No questions on the phone? Okay. Thank you. That means that we can conclude this Q3 reporting event. And thanks for listening in. And I welcome you back to our Capital Markets Day. Don't forget that on November 28th, and the Q4 reporting event. Thank you and goodbye.

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