urenco

Annual report and accounts 2018

Group Finance Report

Revenue broadly in line with prior year reflecting our established order book. Lower EBITDA due to higher net costs of nuclear provisions, with the impact on net income offset by lower net finance costs.

Results for 2018

Revenue

Revenue for the year ended 31 December 2018 was €1,957.7 million, an increase of 1.6% on the €1,926.9 million in 2017. SWU revenues were up by €17.8 million and uranium related sales were up by €62.3 million. For both SWU revenues and uranium related sales the favourable movements were primarily driven by higher volumes with average unit revenues broadly in line with 2017. Other net movements in revenue decreased by €49.3 million compared to 2017, primarily as a result of lower net fair value gains associated with uranium related commodity contracts and marginally lower sales at Urenco Nuclear Stewardship.

EBITDA

EBITDA for 2018 was €1,200.4 million, a decrease of €49.1 million (3.9%) from €1,249.5 million in 2017. This resulted principally from higher net costs of nuclear provisions (€53.6 million) together with higher reported other operating and administrative expenses (€26.3 million), which more than offset the margin impact from increased revenue.

The net costs of nuclear provisions were €174.1 million in 2018 compared to €120.5 million in 2017, an increase of €53.6 million as a result of an increase in the net costs for each of tails, decommissioning and other nuclear provisions.

The net costs for tails provisions in 2018 were €2.8 million higher than those for 2017. This increase was due to the lower costs of new tails provisions created (€54.5 million) being more than offset by lower releases from the tails provision (€57.3 million). The costs of new tails provisions created in 2018 of €144.7 million were lower than the costs of €199.2 million in 2017, largely driven by the volume of new tails generated during the year and the 2017 uplift in deconversion cost estimates not being repeated in 2018. There was a €29.2 million release from the tails provision (2017: €86.5 million), as a result of optimisation of operations and the impact of the reduction in higher assay tails associated with enrichment services contracts.

The net costs for decommissioning provisions in 2018 increased by €42.3 million primarily due to a charge for additional provisions of €65.9 million (2017: €18.4 million) following the triennial review of nuclear liabilities undertaken in 2018, offset by releases of provisions in the year of €8.8 million (2017: €3.6 million) associated with cylinder inventories.

The net costs for other nuclear provisions in 2018 increased by €8.5 million as a result of optimisation of the operations and changes to the forecasts for future re-enrichment of low assay feed.

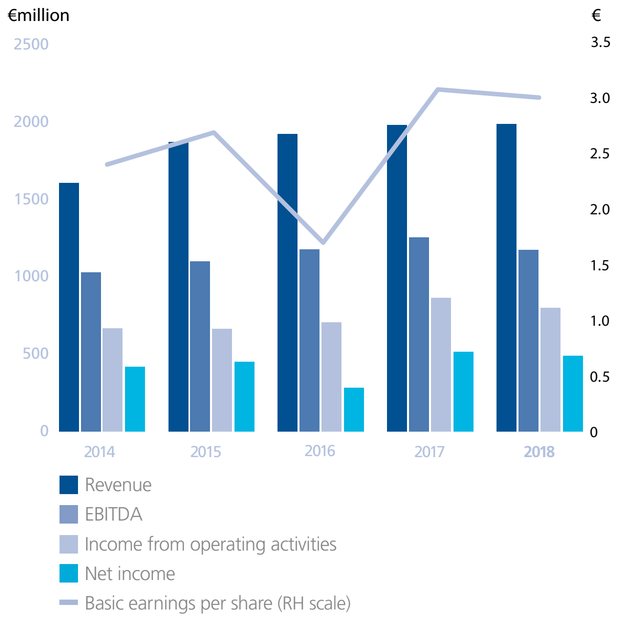
Other operating and administrative expenses were €583.2 million in 2018 compared to €556.9 million in 2017, an increase of €26.3 million. 2017 benefited from a one-time gain of €15.6 million associated with the closure of the UK defined benefit pension scheme to further accrual and in 2018 a provision for a potential bad debt associated with a specific customer has been made of €17.3 million (2017: nil). Adjusting for these two factors, our other operating and administrative expenses are broadly in line with our Strategy 2020 ambition and our cost discipline has continued to mitigate the impact of inflationary pressures as well as additional costs associated with the development of our business.

The EBITDA margin for 2018 was 61.3% compared to 64.8% in 2017. The EBITDA margin in 2018 was adversely impacted by the triennial review of nuclear liabilities referred to above.

EBITDA performance

	2018 €m	2017 €m	% increase/ (decrease)
Income from operating activities (pre-exceptional items)	826.5	871.8	**(5%)**
Adjustment for depreciation	47.5	42.0	
Add: depreciation and amortisation	329.2	343.3	
Adjustment for share of results of joint venture	(2.8)	(7.6)	
EBITDA	1,200.4	1,249.5	**(4%)**

Financial performance



Exceptional items

In 2018 there were no exceptional items (2017: nil) and, therefore, there is no associated income tax impact for 2018 (2017: nil).

In 2016 the Group recorded a restructuring provision of €33.0 million associated with the implementation of our strategy. In 2018, €2.3 million (2017: €4.7 million) of this restructuring provision was released to the Income Statement following a re-forecast of the costs to complete the restructuring programme. The release of restructuring provision in each of 2018 and 2017 has not been classified as an exceptional item as each was below the materiality threshold set out in the Group's policy on exceptional items.

Net income

In 2018 net income was €511.3 million, a decrease of €3.6 million (0.7%) compared to the 2017 net income of €514.9 million. The net income margin for 2018 was 26.1% compared to 26.7% for 2017. The decrease in net income reflects the impact of lower EBITDA, offset by lower depreciation and net finance costs and a lower income tax expense.

Depreciation and amortisation for 2018 was €329.2 million, compared to €343.3 million for 2017.

Net finance costs for 2018 were €106.0 million, compared to €140.1 million for 2017 with the reduction largely due to lower net cost on borrowings (€52.4 million) which were partially offset by higher losses due to foreign exchange movements (€19.8 million).

The net finance costs on borrowings (including the impact of interest rate/cross currency interest rate swaps) were lower at €75.3 million (2017: €127.7 million) reflecting lower levels of net debt in 2018. The other key elements of net finance costs were broadly in line with the costs incurred in the prior year, notably capitalised interest of €56.5 million (2017: €54.8 million) and the unwinding of discounting on provisions of €58.9 million (2017: €55.5 million).

Where practicable, relevant loan balances are swapped using cross currency swaps and these swaps are placed in accounting hedge relationships. Where this is not possible the retranslation of the relevant unhedged loan balances (denominated in US dollars and euros but held by a sterling functional currency entity) generate gains/losses as a result of foreign exchange movements in the year. In 2018 the impact of this was a loss of €30.1 million (2017: €10.3 million loss) reflecting relevant unhedged balances and movements in foreign exchange rates and also includes a €27.2 million one-off non-cash charge for unhedged cumulative foreign exchange losses that should have been recognised in the Income Statement in prior periods from 2014. In addition, a gain associated with ineffective cash flow hedges was incurred of €6.4 million (2017: €5.5 million gain).

In 2018 the tax expense was €209.2 million (an effective tax rate (ETR) of 29.0%), a decrease of €7.6 million over the tax expense of €216.8 million for 2017 (ETR: 29.6%). The tax expense for 2017 included a credit of €74.0 million related to previously unrecognised US deferred tax assets resulting from the impact that the increased centrifuge and associated equipment lifetimes will have on future depreciation.

There was also a deferred tax charge of €85.1 million from the write down of previously recognised US deferred tax assets which has been revalued to reflect a reduction in average US Federal and New Mexico state corporate tax rates from 38.84% to 25.66%, effective from 1 January 2018. Excluding the impact of these two deferred tax items the 2017 tax expense would have been €205.7 million (ETR: 28.1%) compared to the tax expense of €209.2 million for 2018 (ETR: 29.0%).

The increase in the adjusted ETR from 28.1% to 29.0% is driven by four factors: i) changes in the relative proportions of profits and losses generated across the four jurisdictions in which Urenco operates (decrease of 1.7%); ii) the impact of lower overseas tax rates (decrease of 3.5%); iii) the impact of non-taxable and non-deductible amounts, including foreign exchange financing gains and losses that are excluded from tax under the UK Disregard Regulations (increase of 4.3%); and iv) the impact of adjustments in respect of previous years (increase of 1.8%).

Tails deconversion, storage and eventual disposal

Urenco provides for the costs of deconverting the by-product of the enrichment process (chemically converting tails from UF_6 to U_3O_8), interim and long term storage, and eventual disposal. During the year the Group reviewed the costs associated with tails deconversion, storage and disposal.

Additional tails provisions created in the year were €144.7 million (2017: €199.2 million), due to tails generated in the period and an increase in the applied tails deconversion rate due to interim storage assumptions.

Provisions utilised during 2018 were €34.5 million (2017: €110.6 million) and a provision release of €29.2 million (2017: €86.5 million) was recorded as a credit in net costs of nuclear provisions as a result of optimisation of operations and the impact of the reduction in higher assay tails associated with enrichment services contracts.

Plant and machinery decommissioning

Urenco has an obligation under its operating licences to decommission enrichment facilities safely once they reach the end of their operational life. During 2018 the Group carried out a periodic review of the costs associated with plant and machinery decommissioning.

During the year ended 31 December 2018 the decommissioning provision increased by €125.8 million (2017 increase: €50.2 million) due to revised assumptions relating to the decommissioning of plant and machinery of €123.0 million (2017: €40.5 million), additional cylinder purchases of €2.5 million (2017: €8.8 million) and the installation of additional plant and machinery of €0.3 million (2017: €0.9 million).

Of the €123.0 million resulting from revised assumptions, €65.9 million has been expensed to the Income Statement and €57.1 million has been recognised in decommissioning assets.

Urenco continues to prepare for the potential establishment of segregated funds to finance its future decommissioning activities.

Further information on nuclear provisions can be found on pages 105 to 107.

Pictured:
Cylinders being moved at our German enrichment facility.

Group pension funds

Urenco operates a number of pension schemes for our employees in the Netherlands, UK and Germany. These are a mixture of defined contribution and defined benefit schemes.

The net liability for the Group's defined benefit pension schemes at 31 December 2018 was €46.0 million (2017: €97.3 million). This decrease was due to a €68.1 million decrease in the present value of the defined benefit obligations due primarily to a reduction in discount rates together with a decrease in the fair value of the plan assets of €16.8 million.

On 5 April 2017, Urenco closed the UK defined benefit section to further accrual following the conclusion of a comprehensive consultation with employees and their representatives and the pension scheme trustees. Following the triennial valuation of the UK scheme in 2018, a revised deficit repair plan was agreed with the UK trustees. The plan includes deficit repair payments of £6.6 million annually until 2022. The trustees intend to manage the pension scheme so that the economic and investment risks will be reduced through the adoption of a more cautious investment policy and the use of interest and inflation derivative contracts.

The Urenco Nederland scheme has consulted on a transfer of assets and liabilities to a Dutch consolidated pension arrangement, Pensioenfonds Grafische Bedrijven (PGB). The transfer to PGB is expected to take place in 2019, subject to regulatory approval from the Dutch central bank (de Nederlandsche Bank).

Cash flow

Operating cash flow before movements in working capital was €1,293.8 million (2017: €1,188.3 million) and cash generated from operating activities was €1,401.0 million (2017: €1,314.1 million). Higher cash flows from operating activities result from higher revenues and lower spend on the storage and disposal of tails, partially offset by a less favourable movement in working capital compared to 2017.

Tax paid in the period was €119.3 million (2017: €122.9 million).

Net cash flows from operating activities were €1,281.7 million (2016: €1,191.2 million). Net cash flows from operating activities are used to finance investing activities, service the Group's debt, fund dividends to shareholders and, in the future, to fund the long term decommissioning and tails liabilities currently reported in provisions in the Group's Consolidated Statement of Financial Position.

Capital expenditure

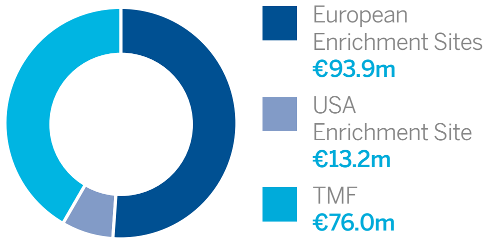
In 2018 the Group invested a total of €183.1 million (2017: €299.5 million), reflecting a lower level of expenditure on core enrichment assets in line with our strategy and the decline in the level of investment in TMF (2018: €76.0 million, 2017: €184.4 million). Construction of the TMF was completed in late 2018 and operations planned to commence in 2019.

Management's current forecast of the costs to complete TMF remain in line with those set out in the comprehensive project review undertaken during 2017. These cost estimates are included in the tails deconversion rate referred to above in the commentary on EBITDA and tails deconversion, storage and eventual disposal.

Capital expenditure is expected to fall further in future years following the completion of the TMF and lower levels of investment required in new enrichment capacity.

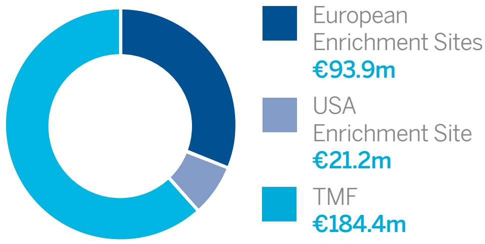
2018 Capital expenditure

(€183.1 million)



2017 Capital expenditure

(€299.5 million)



Capital structure

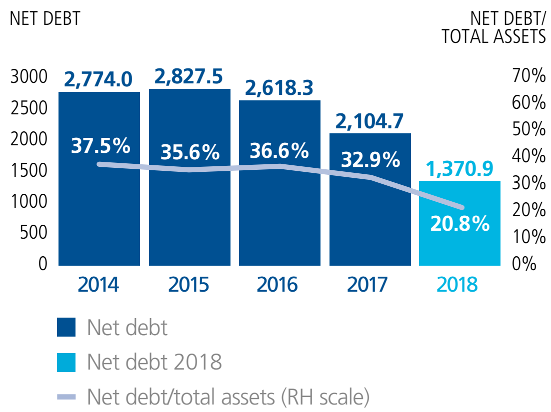
The Group's equity increased to €2,119.8 million during the year (2017: €1,824.3 million) due to an increase in retained earnings of €263.2 million (reflecting €511.3 million of net income, €51.3 million of other comprehensive income for the year and an adjustment of €0.6m associated with the transition to IFRS 9 offset by €300.0 million of dividends paid), an increase in foreign currency translation reserve of €126.3 million, primarily due to foreign exchange gains on property, plant and equipment held in US dollars as a result of the strengthening of the US dollar against the euro, and a decrease in hedging reserve (including cost of hedging reserve) of €94.0 million. The movement in the hedging reserve is primarily associated with mark to market losses on cash flow and net investment hedges, which protect the Group's future revenues and overseas net assets held in foreign currencies respectively.

Net debt decreased to €1,370.9 million (2017: €2,104.7 million). Urenco repaid its remaining loan (€100.0 million) from the European Investment Bank (EIB) on maturity in March 2018, having prepaid other EIB loans (€319.6 million) in December 2017. During 2018, Urenco utilised its one year bilateral loans, each of €90 million, with four of Urenco's relationship banks. These loans were fully repaid and the facilities expired by the year end. In January 2019 the Group also completed the repurchase and cancellation of €215.6 million of its 2021 Eurobonds.

The Group monitors its capital structure through the use of financial ratios, principally those of net debt to total assets and funds from operations to total adjusted debt (FFO/TAD), as discussed further in note 25 of the Group's Consolidated Financial Statements.

Net debt to total asset ratio remained strong at 20.8% (2017: 32.9%), well within the Group's target ratio of less than 60%.

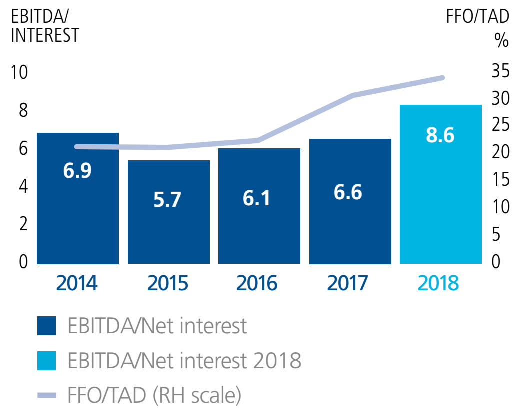
Net debt and Net debt/total assets



The Group targets an FFO/TAD ratio that results in a strong investment grade credit rating. The FFO/TAD ratio was 34.3% (2017: 30.5%) as EBITDA, the main component of FFO, has decreased by €49.1 million while net debt has decreased by €733.8 million.

The Group's interest cover also remains strong at 8.6x (2017: 6.6x).

Five-year summary funding ratios



Funding position

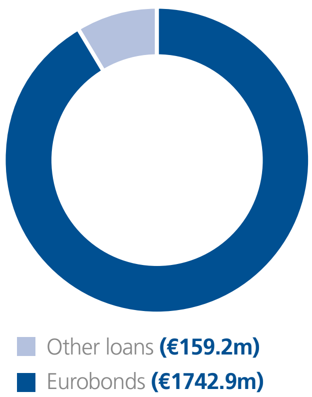
Liquidity continues to remain strong as a result of cash flow generation. As at 31 December 2018 the Group has €750 million of committed undrawn revolving credit facilities which expire in June 2023, as well as cash and cash equivalents of €531.2 million (2017: €59.1 million).

Our funding position remains robust and continues to be underpinned by our established contract order book, which gives high levels of revenue visibility and robust EBITDA margins, resulting in strong cash flow generation.

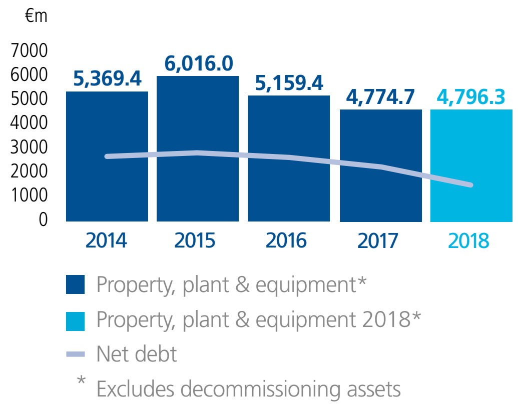
The Group's debt is rated by Moody's (Baa1/Stable) and Standard & Poor's (BBB+/Stable); these external ratings were unchanged during 2018.

Interest bearing loans and borrowings

(€1,902.1 million)



Property, plant & equipment vs net debt



Funding programme

The Group's funding strategy is to:

- Maintain a core of longer-dated debt and committed borrowing facilities, consistent with the long term nature of the Group's investments and the need to maintain an optimised long term capital structure;
- Use a range of financial instruments and financial markets in order to execute attractive funding opportunities as they emerge; and
- Manage debt maturities by raising funds in advance of ultimate repayment dates of debt instruments.

The average time to maturity of the Group's debt at 31 December 2018 was 3.6 years (at 31 December 2017: 4.0 years).

Managing foreign currency risk

Our foreign currency hedging policy has the objectives of reducing volatilities in net cash flow and income, and to protect the income statement from balance sheet re-measurements of debt. However, a long term reduction in income exposure is much more difficult to achieve due to the strict requirements with respect to hedge accounting under IFRS. The functional currency of Urenco Limited is sterling, although the company reports its results in euros.

The Group receives most of its customer revenues in US dollars and euros. The net cash flows of Urenco's European business have been hedged by selling US dollar customer revenue and buying forward the sterling required to meet the costs of the UK operations, and selling the remaining US dollars to buy euros. The net cash flows of the USA business of Urenco have been used to pay US dollar denominated costs.

The Group hedges the impact of changes in foreign exchange rates by using a progressive rolling programme of buying and selling currency over a period of up to six years ahead. This medium term hedging period strikes a balance between the objective of maximising cash flow certainty (which suggests a long hedging period) and the objective of maintaining a hedge portfolio that largely qualifies for hedge accounting under IFRS. Urenco has a stable future revenue stream that is managed using a portfolio of hedges. There is always an element of uncertainty due to changes in quantities and timing of deliveries based on market movements and customers' requirements, which makes it difficult to achieve effective hedge accounting over the longer term.

The Group has a total of €1,034 million (2017: €1,212 million) cross currency swaps, mainly to convert the economic exposure of part of the Group's debt from euros to US dollars that are then net investment hedged for Group accounting purposes. This better aligns the currency of the debt with the asset base and cash flows of the Group.

Urenco Group Financial Policy Statement

The Financial Policy Statement defines the broad parameters for financing the Urenco Group and has the agreement and support of all of our shareholders.

The Group will finance itself through a combination of equity, including retained reserves and debt. Due consideration is given to the Group's long term unfunded nuclear liabilities when considering financing options. Urenco Limited cannot issue new equity without the agreement of all of its shareholders.

In order to achieve an efficient financial profile, the gearing level and financial ratios will be maintained to retain a solid investment grade credit rating for the Group.

At all times, the Group will maintain sufficient liquidity to ensure that it is a going concern and will manage the composition of its debt to minimise risks from market deterioration in liquidity, interest rates or currencies. Detailed treasury management policies set parameters for the management of these risks.

Dividend policy

The Group will aim to pay a dividend out of its annual earnings. The dividend shall be set to take account of net income, cash flows, reserves and the level of credit ratios. Until financial ratios comfortably exceed the minimum threshold for BBB+ at S&P and Baa1 at Moody's, the annual dividend will not exceed 100% of the net income for the year.

A lower dividend may be set when credit ratios, cash flow or funding conditions dictate that this is necessary and, equally, a higher dividend may be declared when the minimum thresholds of the key financial ratios are comfortably exceeded.

In 2018, €300.0 million in dividends for the year ended 31 December 2017 were paid to shareholders (2017: €300.0 million). The Board has approved that dividends of €300.0 million be paid on 20 March 2019.

As at 31 December 2018, the Company had distributable reserves available of €956.3 million (31 December 2017: €820.3 million).

Order book

Urenco has a strong contract order book which extends into the 2030s with an approximate value at 31 December 2018 of €11.9 billion based on €/$ of 1 : 1.15 (2017: €12.7 billion based on €/$ of 1 : 1.20).

Outlook

Urenco's strategy ensures our organisation has a broad and sustainable offering for the nuclear industry. Enrichment remains our core activity and we continue to explore new markets. The expansion of our Stable Isotopes capacity will enable us to serve a growing global market and provide a solid return on our investment. Our expertise in nuclear stewardship will broaden the services we offer to the nuclear industry.

Our contract order book remains strong, with further business secured during 2018. Excess inventories of enriched uranium, which have been contributing to pricing pressures, are decreasing. Market conditions remain challenging and current price levels would not support reinvestment in our enrichment facilities. There is an increasing global demand for sustainable, low carbon energy. As a leader in the nuclear industry, we are well positioned to meet this need.

The principal risks and uncertainties to which Urenco is exposed remain broadly in line with those disclosed in 2017.

We have made robust preparations for the various geopolitical challenges facing Urenco. The actions we have taken in relation to the UK's withdrawal from the European Union and Euratom mean we will meet our customer commitments. We acknowledge the ongoing political debate in Germany about nuclear energy and are confident that we can continue to demonstrate that we are a long term, sustainable operator in the country and are an integral part of Germany's highly impressive technological capabilities. We are actively tracking developments in US trade policy and will continue to provide a secure supply to the country's utilities from our facility in New Mexico.

The Strategic Report was approved by the Board of Directors on 14 March 2019 and signed on behalf of the Board by:

Stephen Billingham

Stephen Billingham
Chairman