

Q4 2016 Earnings Call

Company Participants

- Mário Azevedo de Arruda Sampaio, Head-Capital Markets & Investor Relations

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP's Conference Call to discuss its results for the full year of 2016. The audio for this conference is being broadcast simultaneously through the Internet on the website, www.sabesp.com.br, and on the Engage-X platform, where you can also find the slideshow presentation available for download.

We inform that all participants will only be able to listen to the conference during the company's presentation. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of SABESP's management and on information currently available to the company.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events, and therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of SABESP, and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us, we have Mr. Rui Affonso, Chief Financial Officer and Investor Relations Officer; Mr. Mário Arruda Sampaio, Head of Capital Markets and Investor Relations; and Mr. Marcelo Miyagui, Head of Accounting.

Now, I'll turn the conference over to Mr. Arruda Sampaio. Sir, you may begin your conference.

Mário Azevedo de Arruda Sampaio

Okay. Thank you. Well, good afternoon, everybody. Thanks again for attending our conference call this time to discuss our results for 2016. We'll also go through the water situation in the Metro Region of São Paulo, our 2017 to 2021 investment plan, and investments we have been undertaking to improve water security in the São Paulo Metro

Region, as well as other issues we find of interest of shareholders and investors. This will be a seven-slide discussion, and at the end, we will have the Q&A session.

Let's start on slide 3. Here, we show the company's billed water and sewage volume, which was up by 4.4% last year. This is an increase of 4% of water and with an increase of 4.8% in sewage when compared to 2015.

Here, we also show our billed water volume since 2013, and as you can see, driven by the water crisis, a significant downturn occurred until the second quarter of 2015. And again, since then, we have been seeing a recovery, although still below pre-crisis level, and we'll comment some of that later.

Now, let's go to slide 4, let's go through our financial results. The net operating revenue increased 20.4% over 2015, chiefly due to the 15.2% tariff increase since June 2015. 7.8% of that increase relative to the ordinary tariff adjustment and 6.9% relative to the extraordinary tariff revision granted by ARSESP to compensate for lower volumes due to the water crisis.

Also, highlighting the 8.4% tariff increase since May 2016, the 4.4% upturn in total billed volume as mentioned before. And the reduction in bonus granted to BRL 187 million in 2016 due to the end of the bonus program - if you remember, we cancelled that - compared to the payment of BRL 926 million during the 2015 year. Now it's worth noting also that the revenue increase driven by the factors I just mentioned was partly offset by the end of the contingency tariff also on the same date, by the way, in April 2016, which in 2016 totaled BRL 224 million against BRL 499 million in 2015.

Cost and selling, administrative and construction expenses increased 21.1% in the period. Adjusted EBITDA increased 15% to BRL 4.6 billion, coming from BRL 4 billion in 2015, while the adjusted EBITDA margin came to 32.4% in 2016 against 3.9% in 2015. If we exclude construction revenues and construction cost, the EBTIDA adjusted margin was 43.3% in 2016 against 46.6% in 2015. Net income presented a significant variation and totaled BRL 2.9 billion against BRL 536 million for 2015.

Let's move on to slide 5. This is where we quickly go through the main variations in costs for last year. Compared to 2015, including construction costs, there was a 21.1% increase in cost and expenses. If we exclude construction costs, cost and expenses increased by 26.6%. Now, given these variations, it's worth analyzing them excluding relevant extraordinary items that occurred in 2015 and 2016.

If we disregard the facts of the transaction of the São Paulo State reimbursement in 2015 in the amount of BRL 696 million, and also deduct from the year of 2016, the non-recurring gains obtained due to the migration of 3,572 participants of the Defined Benefit Plan to the Defined Contribution Plan, which generated in the early reduction, net of incentives, in the amount of BRL 307 million in the actuarial deficit. Costs and expenses, including construction costs, would have grown 15.5% last year.

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As for the main items that increased, we highlight estimated loss for doubtful accounts, which came from BRL 2.4 million in 2015 to BRL 90.4 million in 2016. General expenses with a 83.2% variation, electricity up by 14.4% and services by 10%. It's also worth noting the 1% decline in payroll benefits and pension plan obligations, and noting that they were driven greatly by the abovementioned early reduction of the actuarial deficit, which the total deficit amounts to BRL 334 million.

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But given that this value was partly offset by the extraordinary contribution in migration incentives paid by SABESP to those who migrated in the amount of BRL 26.8 million. In net terms, the impact of the migration was the already mentioned BRL 307.4 million. Obviously, for more detailed explanation, we have our press release, and you can always call us for more info.

Now, let's move to slide 6. Here, then we want to quickly go through the main variations between 2015 and 2016 in the items that affected our net income, which totaled BRL 2.9 billion.

Net operating revenues increased BRL 2.4 billion or 20.4%. Cost and expenses, including construction costs, increased BRL 1.9 billion or 21.1%. Other operating revenues and expenses recorded a negative variation of BRL 137 million. Net financial expenses and monetary restatement and exchange variation had a positive variation of BRL 3.2 billion due to the depreciation of the dollar, and again, against the real in 2016, which was 16.5% and 13.9%, respectively, compared with the appreciation of these currencies in 2015, in this case, 47% for the dollar and 45.9% for the yen.

Finally, income tax and social contribution increased BRL 1.1 billion due to the increase in operating revenues and in financial results, in this case, driven by the exchange rate variations mentioned above. These increases were obviously partly offset by higher operating costs and expenses.

Let's move now to slide 7 and let's comment on the reservoir levels and the water production work in the Metro Region of São Paulo. In the pluviometry and affluence graphs for the Cantareira System, we can observe that after a very rainy January, the month of February and March still going, but we're at the end of March, presented a rainfall and affluence below the historical average expected for the period.

However, if we consider the period from October last year to February this year, still in our rainy period, the 991 millimeters rainfall for the period in the Cantareira System was exactly equal to the average expected for the same period. As for water inflow, the expected historical average for the mentioned period is 52.7 cubic meters per second, and as of this end of March, the average inflow was or is around 39 cubic meters. So we're below that. But, nonetheless, and in spite of this behavior in rain and affluence in the Cantareira System, we can see that the total water stored in the reservoirs that are part of the São Paulo Metro Region entire water systems, made of five water systems, is in a very favorable situation.

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The water volume available today, if we disconsider the technical reserve volume, is equivalent to the volume available in the beginning of June of 2013. Now, if we consider the technical reserve volume, which today we have the ability to tap, today's volume is greater than the same - is greater than the last four years for the same month.

In other words, we're in a much better water situation than even in 2013. In numbers, the reservoir of the Metro Region of São Paulo, considering the Cantareira System, technical reserve held over 1.2 trillion liters of water. Just for a comparison, the same date in the year 2016 and 2014, the volumes stored were 900 billion liters and 600 billion liters, respectively. The year 2016 was marked by the discontinuity of the measures adopted through 2014 and 2015 to guarantee the supply in the Metro Region of São Paulo. And in spite of this, the water production volumes continued below those seen in 2013 before the installation of the crisis.

Now, until the beginning of 2014, the average monthly water production in the Metro Region of São Paulo was approximately 69 cubic meters per second, reaching peaks during the year of over 70 cubic meters per second.

During the crisis, water production fell to as low as 50 cubic meters per second on average on a month, includes February and March 2015, compared to today, when it's already approaching 63 cubic meters per second. Well, the explanation for this for this recovery, not to the levels pre-crisis, resides essentially in the change in consumption habits of the population, which we all know adhered aggressively and positively to all the plans to reduce consumption, and then the impacts of Brazilian economic crisis and the impacts on economic activity in the average family income. Well, as shown here, the greater availability of water and lower water consumptions, when we relate that to water production, is a clear indication that the water crisis scenario is in the past, and the water available in the reservoirs in the Metro Region of São Paulo is sufficiently to safely supply its population and, by the way, our consumers, customers.

So, let's move to slide 8. Let's talk about investments in 2016, and what we're going to do and plan in 2017 to 2021. In 2016, investments totaled BRL 3.9 billion. This figure includes investments with non-cash effect. Now, of this total amount, the BRL 3.9 billion that I mentioned, BRL 1.8 billion refers to non-cash effect investments, which means no money was outlaid, disbursed by SABESP. Of this BRL 1.8 billion, of which BRL 1.3 billion refers to the São Lourenço PPP.

It is worth noting that the BRL 1.8 billion investments forecasted for 2016 did not include the abovementioned non-cash effect investment. In 2016, water investment absorbed BRL 2.6 billion or 67% of the BRL 3.9 billion investments, still reflecting the prioritization for adding water security to the Metro Region of São Paulo.

This mix will continue for two more years, when in 2019, the pace or the rate of investments in sewage will accelerate, reaching over 60% by 2020. The investment forecasted for 2017, this year, excluding non-cash impact investment, is BRL 2.3 billion, and again, 67% or over of which is allocated to water.

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For the full period of 2017 to 2021, the plan is to invest BRL 13.9 billion, BRL 7.1 billion of which in water and BRL 6.8 billion in sewage collection and treatment; and once more, just noting that this figure does not include investments with no cash effect such as the mentioned PPP. As of 2019, it's important to note that the rate of sewage investments will increase, and in 2020, it will be prevailing over water and will be slightly over 60%.

Now, let's move to slide 9. Here, we'll talk basically some of the updates, but let's start by talking about the two main investments we have been undertaking to expand water availability and production capacity, and therefore, increasing the water security in the Metro Region of São Paulo.

In 2017, let's start with this one, the interconnection between the Jaguari reservoir and the Paraíba do Sul River water basin and the Atibainha reservoir, which is part of the Cantareira System, and that will add 5.4 cubic meters of water availability. This interconnection will add, again, 5.4 cubic meters of water availability, will be completed. So, by the end of this year, we will be in a more robust position than we have been before.

Now, for early 2018, although we're working to anticipate this, as I'll mention later, the São Lourenço PPP should be completed and will add another 6.4 cubic meters per second of both water availability and production. So, in total, these two projects will add over 11 cubic meters per second of water availability to the region, the latest by first quarter 2018.

Nonetheless, for the São Lourenço Production System, we have already 64% complete. Although, as I mentioned, the delivery is on a contractual base for the first quarter of 2018; we are working hard with them to anticipate the delivery by the end of 2017. In terms of the interconnection between the Jaguari and Atibainha reservoirs, 43% of the project has been completed by the end of this 2016, and we expect to reach 75% of completion by mid-2017.

Let's talk quickly about the second extraordinary tariff revision. Here, we would like to highlight the main events in the period from April to June when the preliminary tariff and the WACC will be disclosed and implemented. This week, we will deliver to ARSESP, our appraisal report on the RAB, so we're on time. Between April 1 and April 26, the regulatory agency will prepare the initial technical note with the preliminary tariff reset and the WACC, so they will be doing their homework. Between April 27 and May 19, ARSESP will disclose its technical note proposal, and we'll open a public consultation, and we'll close the period in May 19 with a public hearing around the preliminary tariff and WACC.

And again, at that moment, the WACC and the asset base will become public knowledge, not only that, but also the initial proposed tariff reset. Between May 22 and June 8, then, the regulatory agency will analyze all the contributions we see, that is the public contribution and hearing. So, you should expect SABESP to file contributions which will potentially disclose what our views on what we think should be the preliminary tariff.

And then, between June 9 and June 10, the final technical note for the preliminary tariff will be published, and a tariff reset will be authorized, remembering that the final tariff will

be disclosed in April 2018. So, that ends the – our presentation here and we're open for questions.

Q&A

Operator

It appears that we have no questions. Now, I'll turn the conference back to SABESP for their final remarks.

A - Mário Azevedo de Arruda Sampaio

Okay. No questions, that doesn't mean – you can call us and we will be totally available for any questions that may come up later on. Thanks a lot, and see you in about 45 days or more for the next quarter results. Bye-bye.

Operator

The conference has now concluded. Thank you for attending today's presentation, you may now disconnect.

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