

Q3 2018 Earnings Call

Company Participants

- Andrea Rangel de Azeredo, Member of Executive Board
- Lino Lopes Cancado, VP E&P Division
- Pedro Zinner, CEO, Chief IR Officer & Member of the Executive Board

Other Participants

- Thiago Silva, Research Analyst
- Victor Hugo Menezes, Research Analyst

Presentation

Operator

Good morning. And thank you for waiting. Welcome to ENEVA earnings call to discuss results of the Third Quarter of 2018. Mr. Pedro Zinner, CEO and Investor Relations Officer; and Ms. Flavia Heller, Investor Relations Manager; are here with us today. (Operator Instructions)

This call is also being simultaneously transmitted on the internet via webcast and can be accessed at ri.eneva.com.br. And also on the MZiQ platform, where the corresponding presentation is available. Slide selection will be controlled by yourself. The conference replay will be available soon after closure. We would like to remind you that webcast participants may submit questions beforehand, which will be answered during the Q&A session.

Before proceeding, we would like to clarify that any statement made during this call regarding ENEVA's business prospects, projections and operational and financial goals reflect beliefs and premises of the company's Board of Directors as well as currently available information.

Future considerations are not performance guarantees. They involve risks, uncertainties and assumptions. And they are related to future events. And therefore, depend on circumstances that may or may not occur. Investors must understand that general economic outlook, industry conditions and other operational factors may affect ENEVA's future performance and lead to results that differ considerably from those expressed in forward-looking statements.

I would like to hand this call over to Mr. Pedro Zinner, who will begin this presentation. Please Mr. Zinner, you may proceed.

Pedro Zinner {BIO 17260844 <GO>}

Thank you. Good morning, everyone. Thank you for participating in this earnings call for the Third Quarter of 2018. Before we begin, I would like you to pay attention to disclaimer on Slide 2.

And we will begin with Slide 3. One year after the conclusion of re-IPO, we closed the Third Quarter of 2018 with adjusted EBITDA of BRL 502 million, boosted by greater availability of our plants and expressed improvement of variable margins in the (parties) and hedge strategies for penalties given due to unavailability.

We have trade in Gavião Tesoura in Parnaíba. And our reserve volume has reached 19.3 Bcm, 9% higher than the same volume in September 2017.

The greater availability of our plants has boosted general net generation that reached 4 million gigawatts -- sorry, gigawatt hours. We have grown 3% in gas generation and 16% in coal generation. Gas consumption in the First Quarter was 0.7 Bcm, according to our dispatch expectation for this period.

Our operational improvement initiatives in carbon generation still continued to provide results.

The adjusted EBITDA of the segment grew approximately 32%, reflecting an improvement of variable margins and number of plants.

In Itaqui, as we had already alluded to in our last conference call, earnings conference, the reduction in ICMS had a relevant impact on margins.

The hedge strategy for penalties due to unavailability, ADOMP, has also contributed to reduce the impact of penalties on EBITDA, generating a gain of BRL 43 million with -- compared to BRL 40 million in penalties in the First Quarter. (sic)

The good operational result and the -- it is leveraged over the last year has led adjusted net income of BRL 180 million. And BRL 53 million were reported -- compared to BRL 53 million in the same period last year. When we examine our business segments, Parnaíba Complex had an income of BRL 184 million. And coal generation reached BRL 38 million.

Operating cash flow totaled BRL 360 million, an increase of 44% versus the Third Quarter of 2017, given the growth in EBITDA and reduced requirements for working capital.

We have closed the quarter with consolidated cash of BRL 1.1 billion. And a net debt-to-EBITDA ratio of 2.7x. We have optimized our capital structure with the restructuring of the (maturity) and closing the Parnaíba Complex. We had our programs approved by the administrative council of the company in October. And we expect restructuring will be completed by the end of the year.

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ENEVA now has -- currently has growth capacity. And this capacity and this growth was due to changes that were made in August this year. We have closed the cycle in Parna ba V. And this was a winning auction that led us to guaranteed contracts over time, with potential growth over the year in installed capacity of 385 megawatts.

In the next slide, you're going to see further details on our operating performance. And I would like to give the floor for Lino.

Lino Lopes Cancado {BIO 20167891 <GO>}

Good morning. I would like to highlight the more important points of our operating performance in this quarter.

In Slide 4, you can see the average dispatch in this quarter. That was in line with what we had in the same quarter last year, with a net generation that was substantially greater, 14% greater compared to the same quarter of '17. And this was due to the greater availability of company assets that reached 94% on average compared to 82% in the First Quarter -- in the Third Quarter of '17.

And we had improvements in availability in all of our plants, except in Itaqu  where we had a shutdown to correct a mismatch with the revamp process in the plant -- the revamp process in the plant.

In this quarter, we also included other initiatives that have been planned in our revamped plants in Itaqu  and Pec m. Itaqu  has reached a net generation of 10,170 kilowatt hour. And this is in line and even better than what we had planned. In Pec m, we have an average unloaded -- unloading time of 4.5 days of ship unloading time, which represents a significant improvement in costs and logistics when it comes to carbon.

We are going to start Slide #5. And here we have our gas assets. Natural gas reserves of the company reached 19.3 billion cubic meters, considering here 1.7 billion cubic meters of Gavi o Tesoura, where we have already announced commercialization last month. Of 1.7 billion cubic meters of Gavi o Tesoura, they are the initial estimates of the company based on a conservative estimate of 0.75. Accumulated consumption of gas in the past 12 months was 1.8 billion cubic meters, considering the consumption was a 99% dispatch of the closing quarter.

Natural gas production has had 14% increase, reaching 0.72 cubic meters as opposed to 0.63 cubic meters of the quarter last year because of lower dispatch of (thermalytic) plant. And the average dispatch of the gas treatment unit, which is 93.5% GTU average dispatch because of greater dispatch from (some of our largest plants.)

Now going into Slide 6. We have our seismic campaign closing in the Third Quarter '18. Over 200 kilometers -- 293 kilometers specifically of seismic data were acquired in the concession. It closed our first campaign which started in 2017. And now we're going into processing and interpretation of data. We have already identified 2 initial prospects. It's

an ongoing exercise. And by the end of the year, we would have already identified the prospect that will be drilled in the exploratory well drilling campaign in 2019.

We have also completed the exploration of 3 more wells on the ninth round of PADs. And one of them has led to an official declaration of commercialization of Gavião Tesoura.

Now I'll hand it over to Andrea de Azeredo, who is going to tell us about our financial performance.

Andrea Rangel de Azeredo {BIO 20613519 <GO>}

Financial performance on Slide 7. We had a 15% increase in our adjusted net revenues, reaching BRL 1.1 billion, positive impact by greater generation of energy. Adjusted EBITDA had 16% increase, going over BRL 500 million as a result of more generation of energy, a number of savings that resulted to positive evolution of variable margins in addition to our very effective hedge strategy.

The company reported adjusted net profit of 239 -- BRL 180 million I mean, as opposed to BRL 53 million in the Third Quarter of '17. It led to a reduction of 34% (sic) in our financial in SG&A with the result and an impact on our final profit.

On Slide 8, we can see the natural progression of EBITDA in -- by segment. We have observed a positive contribution of BRL 38 million from Complex Parnaíba. Gas generation negative impact, which is explained by the gain of BRL 30 million in the Third Quarter '17, resulting from the partial decontracting of Parnaíba II during the second half of '17. If we disregard this effect, we will reach approximately a growth of 4.6% increase as a result of greater availability of the plants, leading to the growth of EBITDA.

Coal generation, we have had a growth and an improvement of variable margin in Itaquí and Pecém II with a better result of the hedge, ADOMP. In the holding, all the expenses were impact by legal and consulting services.

Now on the next slide, Slide 9. The company has invested BRL 32 million in the Third Quarter '18, or 65% (sic) (down 65%) comparing with the Third Quarter of '17. Most resources of BRL 24 million were directed to activities. We had BRL 60 million in exploration starting in the first round of R13; the drilling of PGN in Morada Nova, PGN-25, which has been named Gavião Azul and commercially available; and also the simulation of low permeability reservoirs in GVA. And the remaining was impacts in the construction of cluster 3 of GVA, Gavião.

Now let's go into cash flow, Slide 10. The company has had an increase of operating cash flow with 44% increase as opposed to Third Quarter '17, due to positive variation of EBITDA of BRL 67 million and a reduction of our working capital needs. The workflow (sic) (cash flow) of investment activities was negatively BRL 50 million impact, primarily by the investments in a number of segments.

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Financing cash flow was benefit by the reduction in interest paid as a reduction of indebtedness. And also some decrease in debt indicators. Our cash position including (bonded) was 1.1 billion -- million reais, (sic) (BRL 1.1 billion,) 39% over Third Quarter '17.

Now Slide 11, we can see indebtedness of the company, 9.5%. And the maturity at the end of September was 4.1 years. End of June, our net consolidated debt was BRL 4.2 million, (sic) (end of September, our net consolidated debt was BRL 4.2 billion,) which is a net debt over EBITDA of less than 21% compared to the Third Quarter '17.

Now here we have the new corporate and capital structure restructuring. It was approved by the Board of Directors. The restructuring has a number of additional controls and it expect controls of operation of Parnaíba III and IV and Parnaíba II, which has already been completed; the issuance of new debt by Parnaíba I and Parnaíba II, which is ongoing; partial prepayment of PGN debt; and then incorporation of PGN into our holding company.

Now to Slide 13, we can see that once completed, the restructuring will lead to an extension of the average consolidated debt reaching 4.7 years with significant results of short-term debt, especially by refunding some of the debt in Parnaíba II, BRL 387 million, (sic) (especially by refinancing some of the debt in Parnaíba II, BRL 380 million,) which is something, which will be done on January 3, '19.

I would like now to hand it over to -- for his closing remarks, Pedro.

Pedro Zinner {BIO 17260844 <GO>}

Before we close and opening for the Q&A session, I would like to emphasize that we had very good results in this Third Quarter, with a strong cash generation and improvement in the availability of our plants with maintenance of dispatch responses. And we have concluded initiatives that were associated with revamping of our coal-powered complexes with -- good reflexing in variable margins.

In Gavião Azul, we are moving towards our goals of 100% replacement of reserves in the same year. And finally, the success that we had with our capital restructuring in the company, as Andrea had mentioned, are very important landmarks in this new growth phase.

With these final remarks, I would like to end the presentation. And open for the Q&A session.

Questions And Answers

Operator

We will now begin the Q&A session for our investors and analysts. (Operator Instructions) Mr. Victor Menezes of Goldman Sachs has a question.

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Q - Victor Hugo Menezes {BIO 20240583 <GO>}

My first question is a bit more abundant related to availability of your gas power plants. I would like to know what are your expectations to maintain this level close to 100% for the Fourth Quarter, or if you expect normalization in terms of drop in availability?

And the second question is regards to the closure of the cycle in Parna ba I. Do you have an update regarding constructions that were planned for the beginning of the first semester, or an updated related to financing strategies for this project?

A - Lino Lopes Cancado {BIO 20167891 <GO>}

Victor, this is Lino speaking. For your first question, the availability of our plants, of course, we expect they will be maintaining the same level. We have good availability at the moment. And we are more concerned about dispatch, because in this Third Quarter, we had a smaller -- a lower dispatch compared to what we had before. And this was impacted by the rain, heavy rainfall that we had. So we had a lower dispatch than expected.

As regards Parna ba IV and the construction process, we are now entering the contract drawing phase. And we expect to complete this up to February or March next year. And once we have these contracts, we will then begin the project. And this will begin with an engineering phase that we expect to finish by the second semester of 2019. I will hand it over to Andrea. She will talk about financing for this project.

A - Andrea Rangel de Azeredo {BIO 20613519 <GO>}

About the financing of this project, we are evaluating the existing options. We have more structured options and also cap rate options. We will know a bit better about the structure we're going to use. And what we can tell you is that we have robust cash at the moment. And that gives us a lot of confidence to conduct the first months of the project -- or to complete the first month of the project -- the project, I'm sorry.

Operator

(Operator Instructions) Mr. Thiago Silva from -- has a question, from Santander.

Q - Thiago Silva {BIO 19419043 <GO>}

Just going back to dispatch issues and thinking about the next upcoming year of even up to 2020, I would like to know if you have some expectations to have a line already operating with energy from Belo Monte? Are you comparing this dispatch with availability in this line?

And the second question will be in the First Quarter of the year, you have mentioned -- you talked about growth opportunities in greenfield and brownfield. And I would like to know if you're still looking for growth in these 2 areas?

A - Lino Lopes Cancado {BIO 20167891 <GO>}

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Well regarding the dispatch, we expect to keep the same level of dispatch compared to this year and the previous year. So about 50% to 60%, let's say average 55% even with this new transmission project. This transmission project let us operate a continuing line in (Himadeira). And this has increased the energy availability for the southeast region. And we still are -- we are also using air energy or wind energy.

Of course, this energy (offer) has been increasing. And we had a very rainy period. But we do expect to have the same level of dispatch for the next 2 or three years. And that's the furthest we can forecast. As for your second question, I would like to Mr. Zinner to answer it.

A - Pedro Zinner {BIO 17260844 <GO>}

Thiago, regarding our growth strategy, I think that when you -- this is part of the discussion we had in the first semester that included large projects, the cycle closures and also the loan project. We were successful in the completion of the cycle. And although we had a lot of competitive (sic) with lower demand, we could still complete the project.

We still have this in our portfolio. And we want to develop this project focusing on returns. We believe we will remain competitive. We are going to have further meetings. And we are trying to study some alternatives to optimize our results, given what we have in the market now. So we are open at this moment for this sort of growth.

Inorganic growth, we saw a significant reduction in leverage over the last two years, where we had 2.6 net income-EBITDA ratio. And this has opened some space for us to introduce growing strategy. Inorganic growth is part of our duty. And we are always looking for opportunities. And this is all I can tell about our capital at the moment and the growth perspectives that we have.

A - Andrea Rangel de Azeredo {BIO 20613519 <GO>}

Thank you. This is Andrea de Azeredo. We were asked a question from the webcast. And the question is about when we expect to start paying out dividends? We are right now making investments. We are calling it a cycle coming to the end of cycle. We do not want to pay dividends by 2021 when we have more capital investments. And we have BRL 6 billion also, a loan to pay with the holding. And that will take a while to pay back.

Operator

Thank you. If there are no further questions, I would like to hand it over to the company for the closing remarks.

A - Pedro Zinner {BIO 17260844 <GO>}

Thank you, all very much for participating in one more of our earnings conference call. And I hope to see you again, the beginning of '19 for the Fourth Quarter '18. Thank you very much.

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Operator

ENEVA's conference call is closed now. Please disconnect your lines. And have a good day. Thank you.

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