Q2 2017 Earnings Call

Company Participants

- Flavia Martins, Chief Financial Officer
- Pedro Zinner, Chief Executive Officer and Investor Relations Officer

Presentation

Operator

Good morning. Thank you for standing by. Welcome to Eneva's Audio Conference to discuss numbers relative to the Second Quarter, 2017. Today with us, we have Mr. Pedro Zinner , CEO and IRO. This event is being recorded and all participants are connected in listen-only mode during the company's remarks.

At the end, we'll start a Q&A session and further instructions will be provided. (Operator Instructions) This event is also being broadcast over the internet by webcast and maybe followed at the following URL, ri.eneva.com.br and also at MZiQ platform, where the respective slide deck is also available. Slide selection maybe controlled by the audience.

A replay of this event will be available after the closing. Once again, participants might post their questions on the website, questions, which will be answered at the Q&A session.

Before moving on, please bear in mind that forward-looking statements made during the audio conference

concerning the company's business outlook, financial and operating targets, and projections are based on beliefs and assumptions of the company's management, and also on information currently available.

Forward-looking statements are no guarantee of performance. They involve risks, uncertainties and assumptions, as they refer to future events and may therefore depend on circumstances that may or may not materialize.

Investors should have in mind that industry conditions, general economic conditions and other operating factors might affect Eneva's future performance and thus lead to results that might differ considerably from those expressed in these forward-looking statements.

I'd like now to turn the conference over to Mr. Pedro Zinner, who will start the presentation. Please, Mr. Zinner, you may proceed.

Pedro Zinner {BIO 17260844 <GO>}

Thank you. Good morning, everyone, and thank you for participating in our audio conference to discuss Eneva's numbers for the second quarter 2017. Here with me, we have CFO, Flavia Martins; E&P Operations VP, Mr. Cancado; and Flavia Heller, who is in charge of the IR department.

As you will be able to notice during the presentation, the company has been showing continuous improvement in its asset management, leading through an increase of 40% in its operational results and an EBITDA growth in the first half of 2017 of 13%. The adjusted EBITDA reaching BRL473 million.

With increasingly efficient management of our assets combined with a better capital structure, we have consolidated our model for integrated energy generation, which we call reservoir-to-wire, that's establishing the basis for the company's continuous growth. I hope I can share with you some of this vision in the coming slides.

We also be talking about the highlights of the quarter on slide number three. We'll see details throughout the presentation and our summary with the lower level of dispatch has impacted our results in the quarter.

Then we had a drop of 36% in the average dispatch in the second quarter 2017 when compared to the same period of last year. The recurring -- adjusted recurring EBITDA for the second quarter of this year reached the level of BRL216 million, down 4% from the same period of last year 2016.

The company presented an operating cash flow before interest expenses of BRL244 million in the period, an increase of 60% when compared to the second quarter of last year, which goes to show the company's robustness in the assets and the importance of always looking to implement a more increasingly efficient operation.

Our cash position at the end of the second quarter was BRL671 million, up 34% from the same period of last year.

Eneva's generation in the second quarter of 2017 was 609 average megawatt, a drop of 52% when compared to the second quarter of 2016, driven mainly by the reduction and the dispatch levels that I've just mentioned.

As for the first six months of the year, the adjusted recurring EBITDA grew 12.5%, reaching BRL473 million, which is the result of our continuous effort in increasing efficiency and in mitigating costs and expenses. Along those lines, the EBITDA by generated megawatt hour increased from BRL87 in the second quarter of '16 to BRL177 per megawatt hour in the second quarter 2017, an increase of 102% in the period.

Let's now move on to the operational performance on slide four. As it has been mentioned in the second quarter of the year, the average generation dropped by 62%

when compared to the same period of last year, which is 609 average megawatt.

As we saw in the first -- the first three months of the year, the dispatch levels in the second quarter for the Parnaiba Complex and Itaqui remained at a low level, below that of previous years, reaching to a dispatch for Parnaiba of 21% and for Itaqui of 16%.

The average dispatch for the first half of the year was 23%, proving our view of the seasonality for the Northern market with lower dispatches in the first half of the year and higher expected for the second half of the year -- higher level of dispatches. This evolution -- or this behavior of dispatch in the first quarter, which is lower, which has already been taken into account in our company structure can be explained by three factors.

First, high level of the -- one of our reservoirs. Number two, an increase in our installed capacity at Belo Monte, and number three, to the limitations and the transmission capacity from this North subsystem to the other subsystems.

As a result, the marginal cost of operations is now at a very low levels, and has been such since February. And the resources we have allocated to the North system for Parnaiba and Itaqui respectively were remained disconnected until the end of May.

Now breaking it down per segment, the average generation for gas power plants was 61% lower when compared to the for -- same period of last year. As for the coal segment, the drop was flat, sharp in the magnitude of 40%.

The Pecem thermal plant, the Pecem II is connected to the Northeastern subsystem and has been suffering the impact of hydrological issues. It was the only one to maintain a high level of dispatches in the second quarter of this year at 84%, which is in line with what we saw last year in the same period.

For the second half, we still expect to have higher level of dispatches in the Northeastern subsystems. The Parnaiba Complex is already operating at full capacity, and we expect to have a strong level of dispatch in the second half for all areas.

For (inaudible) in terms of operating performance, now moving on to slide number five, the availability of our plants in the Parnaiba were impacted by preventive shutdowns -- preventive maintenance shutdowns, both Parnaiba I and III were shutdown for 30 days, and Parnaiba II was shutdown for 10 days for maintenance work.

During the maintenance shutdown, we serviced the gas treatment unit as per operating safety regulations. As for Parnaiba IV is the only thermal plant, where we have a sales contract in the free market, and it remained disconnected in the first half of 2017.

ENEVA bought the necessary energy to meet contracts that we have signed, bilateral contracts, and we bought the energy to our energy purchase unit.

As for coal, the coal assets, our availability in Pecem II was also affected, due to the programmed maintenance shutdown, which started in June, and it's scheduled to last for 50 days, then of which, we will be under the third quarter. The availability for Itaqui was positively impacted in the second quarter. It's worth mentioning that even with the programmed shutdown, our coal plants improved when compared to the second quarter of last year. And also an equivalent performance when compared to the previous quarter.

Now, moving on to slide number six, financial performance, we may highlight, even though, we had a drop of 36% in the average dispatch in the second quarter of 2017, our net operating revenue grew by 4%, reaching BRL486 million. This was also positively impacted by the readjustment of inflation for the fixed income, fixed revenue contract and by our fixed revenue coming from Parnaiba II.

Recurring EBITDA reached a level of BRL216 million, and we feared a drop of 4% when compared to the second quarter of 2016. The drop may be explained by the lower dispatch levels, by the accounting of one month of inflexibility at Parnaiba II, and by the start up of the our -- 13 [ph] seismic campaign. As mentioned before, when adjusted for the generated energy, the energy -- the EBITDA is rather double from BRL87 megawatt per megawatt hour to BRL177 per megawatt hour in the second quarter of 2017.

The adjusted EBITDA margin in turn dropped 4% in the second quarter, down to 44%. The drop in margin can be explained mainly by the lower dispatch level at Parnaiba, with a negative impact on the margin in the upstream segment.

Flavia Martins

Now analyzing the evolution of EBITDA per segment on slide seven. We can observe a contribution of BRL18 million in the coal business. This is explained by the lower dispatch levels of Itaqui and the improvement in the cost and structure of the company. It is also explained by the inflation adjustment on the fixed revenue on the power purchase agreement.

It is worth mentioning that our focus is maintained in improving the efficiency of our plants, especially in Itaqui. In the last quarter, we have reached an availability level of 96.5% in that brand compared to 65% in Q2 2016.

Analyzing EBITDA variation, Parnaiba Complex, and it had a negative contribution of about BRL14 million, given the reduction in dispatch levels in the period. The holding has a negative contribution to EBITDA. That has been impacted by the new allocation of corporate costs stemming from Parnaiba Gas Natural and ENEVA in it's spinoff [ph].

Slide eight shows an overall perspective of the Parnaiba Complex. The dispatch level dropped, as mentioned before, in the second quarter of the year, had a negative impact on the EBITDA of the segment, 14% drop to BRL187 million. The gas production dropped 54%, due to a lower dispatch level, reaching 0.14 billion cubic meters.

A lower level of production had a positive impact on the reserves on natural gas. The remaining certified reserve on June 30th were 18.4 cubic meters. The period to the remaining reserves at the end of the second quarter of last year, despite the accumulated production of 1.5 billion cubic meter of gas.

In the second quarter of 2017, the adjusted EBITDA of the natural gas production segment reached 141 million, a 62% increase when compared to the amount of the second quarter '16, with a 13% increase in the EBITDA margin, reached 43% in the first half of the year.

The adjusted EBITDA of the upstream segment in the quarter, reached BRL45 million with the EBITDA margin of 51%, which had an impact in the variable income, because of the higher dispatch level of the plants.

Given the structure is significant here, lower dispatch levels significantly affect the EBITDA margin of the segment.

Now looking into the coal assets performances in slide nine. EBITDA grew 14%, reaching BRL68 million. Itaqui plant had a positive impact, with a lower dispatch level in the first quarter of '17, and also with the inflation readjustment on the fixed revenue after power purchase agreements. The fixed costs of operation and maintenance were reduced by outsourcing those services in the plant.

EBITDA in Itaqui grew by 18% in this quarter, reaching BRL49 million. At Pecem II, there was a 4% drop in EBITDA, reaching BRL90 million, which has suffered an impact in the logistics cost of coal transportation, because of the conveyor [ph] about maintenance services a t Pecem II, also because of the emergency water charges that were collected.

In May of this year, the Federal Regional Court has deferred the injunction filed by Pecem II and according to that decision, it was determined the pass-through of the amount charge by the State of Ceara, as Emergency Water Charge to the unit variable cost of the power plants, and also the suspension of the imposition by ANEEL of any penalty, due to reduced and/or interrupted power generation by the Plaintiff, because of the reduced water.

Slide 10 shows the investments. Here, we can see an increase of 69% when compared to second quarter of 2016, therefore reaching BRL91 million in this quarter. Most of this resource is focused on the continuity campaigns developed the production of Gaviao Caboclo and Gaviao Azul fields. It's important to highlight that the importance of investing in the maintenance of the production system of the Parnaiba Complex System. We are now giving continuity to the exploration of certified reserve.

These two first fields are expected to produce in November this year. In gas production, about 22 million were invested in overhaul and general improvements at the Itaqui plant.

Slide 11 shows that the company has had the operational cash flow before interest expenses of 44 million -- 244 million, a 60% increase compared to last year in the same period. This shows how important it is to constantly pursue a more efficient production. The consolidated cash position in the second quarter reached BRL671 million, a 34% increase when compared to the second quarter of '16.

The cash flow free to the shareholders was about BRL52 million, impacted by the development of gas production as mentioned previously. We have analyze the first -- by analyzing the first six months of 2016 -- 2017, there was a 35% increase in the operational cash flow, BRL363 million in the first half to 431 million in the first half of 2017, so an increase compared to last year.

Slide 12 shows that in June 2017, the consolidated liquid net debt amounted to BRL4.4 billion. The average -- weight average that cost of 11.9% a year with an average maturity of five years. Half of ENEVA's debt is index to floating CDI. So an interest drop has been observed in the Brazilian market, which has caused a positive impact on the financial results of the company.

We are constantly pursuing improvements in the financial structure and cost structure of the company, and we have a small amount of our debt for 2018, and this is more in alignment with our business needs.

As highlights of the quarter, we have 40 million debt in Parnaiba, that is being postponed to January 2019 and an approval of an operation is going to leverage Itaqui, and we will increase the leverage of Parnaiba III with the reduction in costs and better use of financial cost.

Regarding the leverage of the company, there has been an improvement in the EBITDA net debt. In one year, there has been a five fold reduction from 5 times to 3.5 times.

I would like to wrap up this presentation highlighting that now with water stability, and now that it's easier to predict the dispatch levels, our integrated reservoir model is a great -- reservoir-to-wire is a great option that has made even the government to acknowledge in a public consultation that this model should be rolled out.

We are committed with operational excellence, and we are pursuing the best capital structure possible, focused on improving our efficiency, and consequently, the profitability of our assets.

We will keep on working to maintain and develop business in the power segment, generating value to our shareholders and to our employees.

Thank you. And I would like now to open for questions and answers.

Operator

Thank you. We will now start the Q&A session for investors and analysts. (Operator Instructions). Thank you. Since there are no questions, I would like to turn it over to the company's management for their final remarks.

Flavia Martins

Thank you for participating in this conference call. And I hope to have you here again the next quarter. Thank you.

Operator

Thank you. ENEVA's conference call is now over. Please disconnect your lines, and have a nice day.