

Q2 2013 Earnings Call

Company Participants

- Eduardo Karrer, CEO, Director IR
- Frank Possmeier, Deputy CEO
- Marcus Temke, Director, Engineering & Implementation
- Unidentified Speaker, Analyst
- Xisto Vieira, Director, Energy Regulation & Trade

Other Participants

- Bernardo Bresernii, Analyst
- Jackson Raphael, Analyst

Presentation

Operator

Good morning. Welcome to MPX conference call to discuss the results of the Second Quarter of 2013. And update of its projects. At this moment, all participants will be in a listen-only mode. Later we will conduct a question-and-answer session when further instructions will be given. (Operator Instructions)

I would like to remind you that this conference call is being recorded. I would like to now give the floor to Mr. Eduardo Karrer, the CEO of MPX. Mr. Karrer, you may proceed.

Eduardo Karrer {BIO 15883150 <GO>}

Thank you. Thank you very much. Good morning, to everybody. We would like to start here. Thank your participation in our second Q call, highlighting that I do have today with me here the IR team headed by Flavia Heller and several of the management team of MPX, my colleague, Frank Possmeier, Deputy CEO. I have Martia Sreep [ph] and Xisto Vieira, Leandro [ph], Leonard [ph], I mean Rudolph, Marcus Temke. So I think the big part of the officers of the Company are present here today with me at this call.

I would like to start making introduction in terms of highlights and subsequent events stating that this quarter we -- I mean, this was a tough quarter for us, because we still face the final stage of the ramp up of certain of our plants to reach base load operation. So this is reflected in the numbers. Despite that we reached commercial gross generation capacity approximately of 1,800 megawatts, which was in line with -- we were expecting.

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It's important to mention that we do have additional 1,100 megawatts currently under construction that should be added to our portfolio between the second semester and early next year.

Generation net revenues amounted to north of BRL500 million, which is a positive trend. So in general what we do see that there is a couple of tough quarters in the first semester. But with some good signals in terms of this upward trend. We recognize all the one-time events that we faced. But in general you are going to see that we have some clear signals in some areas here in operations which you have lots of challenges. But we are making progress in several plants.

In the financing, Frank will make comments to you. So we do have several challenges. But we have been making progress in the last three months in this quarter specifically.

The other thing to be highlighted is that stable operation of the Parnaíba Complex, in which we do have four separate phase up and running on a base load basis consuming approximately 4.5 million to 4.6 million cubic meters per day on a very stable basis. So this was very good news for the Company as well.

I think on the strategic front, I think the changes in the controlling group, which was a very important milestone for the Second Quarter in accordance with planned. Having E.ON increasing its participation to 36.2%. And joining Mr. Eike Batista in the controlling block of the Company. And on a shared control basis. And some changes in our Board of Directors with our former Chairman Eike Batista reducing this -- his stake to 29% and resigning from the chairmanship and membership of the Board of MPX. So this is an ongoing process right now. And -- but this, I call this as part of this new momentum of the Company with this new controlling group leading the Company from now onwards.

I would like also to highlight that the numbers that we are going to be seeing, they are somehow impacted by some ongoing regulatory discussions that we are currently having with ANEEL. So this is an important part of our business. So but this still is reflected in the numbers of the second Q. And we do expect to have an outcome for these discussions within the coming months.

So having said that, moving to slide number 4, I pass to my colleague, Frank Possmeier. Thanks.

Frank Possmeier {BIO 18083214 <GO>}

Thank you, Eduardo. Let me build up on one of the topics you just mentioned, which is the change in the controlling group that we had. And you all know that it was in conjunction with the capital increase that we agreed in April and that was modified in July, August. And in our last call we informed you about the new structure and the new pricing of that capital increase. And we would like to give you an update on where we are.

We successfully launched that capital increase and in the first phase in the initial preemptive period approximately BRL520 million were subscribed to. BRL300 million of

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this were subscribed by E.ON approximately and 220 million by minorities. So a significant portion, approximately 80% of the minorities participated in the capital increase and supported the Company in the future growth.

The next step is that we will have subsequent periods, the first one starts today. Actually, the first additional subscription period that will end in two days. And then afterwards two other periods. And the ultimate end and finalization of the capital increase is expected for the end of August. And what we expect as an outcome of the capital increase is under the assumption. And I think that's a rather realistic assumption, that Eike Batista will not participate in the capital increase. It's a shareholding structure where we have 38% of free float, 38% of E.ON and approximately 24% of Eike Batista holding in MPX.

It's important to mention at this topic that we will not see any change in the shareholder agreement. It's still stable as agreed and as signed upon to in April. And nothing will change to the controlling group meaning MPX will still be controlled by Eike Batista and E.ON together.

Turning from that strategic picture and the more global topics to the underlying business that we have. As Eduardo mentioned, the First Quarter was characterized by ramping up our operational fleet. And with all the problems that occur when you ramp up an operational fleet of delays and potential unavailability, testing of plants et cetera. Nevertheless, we had an improvement of our net operating revenues by approximately BRL200 million and has a very stable business in Parnaiba and the Parnaiba Generation complex of approximately 680 megawatt of capacity. And we had approximately a month out of trips -- without of any trips in Itaquí and a very stable business there, supporting our net revenues.

In conjunction with increasing revenues, we also see operating costs ramping up by approximately BRL100 million, 34%. Part of that is if you have additional capacity on line, you obviously consume more fuel, like coal and gas and that is part of the operating costs got up -- that went up. But also. And we have to acknowledge that too to the difficulties we had in the Second Quarter in ramping up the plants we had some need for energy acquisition; less than in the First Quarter but there was still some that was needed. And we had unavailability charges approximately in the overall quarter of BRL70 million that we had to pay and then a part of our operating cost that you see here on page 5.

For the ramp up and the operational performance, I would like to hand over to Marcus Temke, our Operational Director.

Marcus Temke {BIO 15883157 <GO>}

Thank you, Frank. Good morning to everybody. I think what I would like to convey to you is, as Frank already stated on Parnaiba we had a very solid start up and a very reliable operation except for a minor planned shutdown in May, which was required to upgrade the substation switchyard to connect the future plants with being running very, very stable. Unfortunately, with the high spot prices at the time you will see an impact of this shutdown. But what we see from now on is a very stable and a reliable operation.

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Itaqui also, I think we can tell you that there is a big and consistent improvement in the operation. The unit has been running consistently above 360 megawatts. We had also a shutdown in May, where we had to make some corrections to fix and maintain certain equipment but also we used to implement some improvement. And from there on what we see is really much more stable operation. The consumption of diesel, which hurts us because of the higher costs, whenever we have disturbance in the plant, has decreased also significantly. So we see improvements in all metrics which we track regarding the Itaqui plant.

At Pecem II, we did all the commissioning phase. This was by far the best part of our coal fleet. Of course we could use the lessons learned in the other plants. And what we -- the situation we have today is that the plant has been tested. We have achieved all the requirements from the system to get the commercial operation by the end of June. And we have also -- whenever we had the chance to use the transmission line from Pecem I to go to full capacity which we operated several days. So the unit is really ready.

Unfortunately, the definitive connection is not ready and this is an issue which we are working with ANEEL as well. But I think the message is that it was our best startup in coal and the unit is ready and in very good conditions through -- to get commercial as soon as we fix the regulatory side.

And of course last but not least, Pecem I is where we are today putting a huge focus on it. Both shareholders are putting all efforts and putting all their resources available to help the Company. We had also some impact created by a shutdown we had to do in late April, early May, where we could also do some fixes and improve certain elements of the plant. And unfortunate events of three external transmission shutdowns or transmission-related shutdowns which also hurt us in late June, early July. But we are now in our opinion in the right way to get the right changes and to have also the results we had in Itaqui showing up there in Pecem I.

Having said that, I pass back to Frank on slide 7.

Frank Possmeier {BIO 18083214 <GO>}

Thanks Marcus. I think it's really important to see that we are able to stabilize our operational business here on our consolidated power plants. We feel very confident with the Parnaiba Complex, with our Itaqui business, then Pecem II coming online in the Third Quarter approximately. And as Marcus mentioned ready to rumble. It's really all tested and in a good shape. So we think we will have a very good operational Third Quarter ahead of us. And are very confident that we will report in November when we sit here at this call for the Q3 numbers, a very stable operational business.

Let me move to our SG&A overhead operating expenses, some good news here as well. Compared to the Second Quarter last year, we were able to reduce our SG&A and overhead costs by approximately 13%. Half of that is due to the spinoff of the Colombian business. So potentially a one-time effect. But the second half of that is a recurring effect where we see an optimization of the outsource business that we have with EBX Group. We

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have reduced lease and rent costs and we have also a reduction and less spending in advertising and marketing which we think will be stable. So good news that we are able to reduce our SG&A cost in the long run here.

Moving forward to our consolidated EBITDA. So the business that's 100% or is fully consolidated in our balance sheet and our P&L. We have a reported EBITDA of minus BRL40 million. And if we deduct the one-off item that were mentioned previously, meaning the net cost related to the energy acquisition and take into consideration the amount of money we got from the regulator for that energy acquired, the unavailability charges that were imposed upon the Company and the startup costs mainly due to higher diesel consumption, we would have derived at a consolidated EBITDA in the Second Quarter of approximately BRL50 million. This takes into consideration the operations of the Parnaiba I complex and Itaquí, not the EBITDA of Pecem, which would be -- of Pecem I, which would be on a normalized quarter approximately the proportion for MPX between BRL20 million and BRL30 million.

Turning to page 9, which essentially shows us -- you the picture of apart from bringing online our operational fleet and stabilizing the operational business, will dedicate and will dictate our second half of 2013, which is take care of the debts that we have at MPX. You see currently in our balance sheet overall debt profile of approximately BRL5.7 billion. Out of that, BRL3.1 billion is project related long-term debt, where we feel rather comfortable that the cash flow of the project will serve that and the short-term debt is approximately BRL2.6 billion.

Out of that BRL2.6 billion, again BRL1.1 billion relates to projects, BRL850 million to Parnaiba I and II. So we -- power plants where we see stable cash flow in the future -- currently and in the future, where we don't think this is any problem at all for the holding level. So something that will be served by the project which translates then ultimately in a holding debt of approximately BRL1.5 billion.

What do we do to refinance that BRL1.5 billion, we will have a pay down of approximately BRL100 million in August in the next days to come, BRL350 million we will refinance via a debenture issuance in Itaquí to occur in October. And then we have a remainder of approximately BRL1 billion. And that BRL1 billion will be refinanced at the end of the year, latest beginning of next year with long-term debentures at the holding level, supported by the cash flows from the operating plants that we have online there.

We think we can achieve five to seven year maturity on the long-term debenture, which really brings us into a comfortable position on that BRL1 billion of debt financing.

Last but not least, I want to focus on page 10 on the cash position of the Company, building on a starting and cash position of approximately BRL370 million at the end of the First Quarter. And adding to that our revenue of approximately BRL290 million, we have a starting position of BRL650 million cash available during the Second Quarter.

We dispensed approximately BRL480 million of that in CapEx and OpEx and we paid down BRL180 million of debt in the Second Quarter. And in addition to that had to raise

[ph] again BRL240 million of debt. So if you compare the debt service we did of approximately BRL180 million and the debt rate BRL240 million, we have a delta of BRL60 million. And if you take into consideration via the fore mentioned BRL100 million that we will pay back in the next phase, essentially we haven't really taken on additional debt. But we reduced our debt position at holding level.

We had an intercompany loan to our project (inaudible) of approximately BRL65 million. And some minor items that ultimately translate into a cash position. The total capital increase that is really important to mention of BRL150 million at the end of the Second Quarter, taking now the capital increase of BRL800 million into consideration that will come in the First Quarter, we think that we have a rather stable cash position for the second half to come.

Now handing over again to Marcus to give us an overview of the development of our fleet.

Marcus Temke {BIO 15883157 <GO>}

When we see the next plants to come in as I already mentioned, Pecem II is ready, tested, it's just a matter to get the connection. On Parnaiba II, we are on track to meet PPA targets starting early next year. Parnaiba III, which is the Nova Venecia project, is in final commissioning stages. And soon early October we believe that to run the plant. And the Parnaiba IV project is also on schedule for December. So what we see here is early next year close to 3 gigawatts of installed capacity running for MPX.

Xisto Vieira {BIO 2378129 <GO>}

Just a brief on slide 12. Yes. The next slide, this shows that there are some ongoing regulatory discussions with ANEEL; actually we have three discussions, (inaudible) discussions with ANEEL and one with the Ministry of Mines and Energy. The three with ANEEL are the following; the one regards the criterion for taking into account the penalties for energy ability of the plant.

The second one has to do with the pass through criterion for the energy that we had to buy for the plant to lease [ph]. And the third one is exactly what Marcus Temke has mentioned before, which has to do with the fact that we are ready to go in the plant of the II. But the substation of Pecem II, which will receive this plant is not ready yet. It has been postponed, the official date is September, the end of September. So we have to discuss with ANEEL how to take that into account.

With the Ministry of Mines and Energy we are discussing the problem of having a capacity superior than -- that one that we went to the auctions. We have actually a difference of 10 megawatts per machine. Then we are asking the Ministry of Mines and Energy to increase our feasible guarantee so that we can negotiate this difference in the free market. So these are the main issues that are under discussion.

Eduardo Karrer {BIO 15883150 <GO>}

Now it's Eduardo, slide number 13, about the E&P on Parnaiba. I would like to highlight that in this past quarter we drilled five new wells, all of them wildcats. We did have some very nice discoveries in the region. So currently you can see the prospects highlighted in the slide. But more important than that is to tell you that today we are working on the so-called Lonjawalia Sul [ph] evaluation plant for each discovery in order that we can submit that to the agency. I mean for sure, for each of these discoveries we are going to shoot additional 2D seismic in order that we can go throughout the B-10, B-50, B-90 [ph] and reserves booking process.

So this is a very intense work going on right now. We are producing right now only from the Gaviao Real field in the level that I mentioned before, 4.6 million cubic meters. We do expect to reach in the next level 5.5 million cubic meters, then by year-end 6.5, 6.6 million cubic meters. And throughout the first semester of next year 8 million cubic meters per day, which is going to be the full capacity to fulfill all our existing contracts.

So lots of milestones ahead. On top of this production development scenario we do have a lot of work in the exploration front in order that we can drill as much as we can, shoot as much seismic as we can in order that we can retain as much acreage as we can by April next year.

We do -- I think it's important from a strategic standpoint that all these discoveries that we had in Parnaiba, they characterize what we call the trend, the macro trend of the gas in the basin. So I think the challenge now is for the exploration guys as we are drilling very fast to establish locations, to keep the rig up and running 100% of the time. So we are doing -- we have been doing a lot of progress in Parnaiba, lots of achievements. But lots of work to do, lots of pending items to reach all the following steps as I mentioned before.

I think it's very important from my end also to highlight how well the work has been functioning between our operation scheme and the E&P operation scheme on a one team basis. So this has again added a lot of value to the whole field's development.

Complementary on what Xisto mentioned in the past slide, going back to the regulatory issues. I will like to highlight Marcus didn't touch that. But that the coal plants, we did reach 370 megawatts 375 megawatts for a couple of them, Itaquí and Pecém II. So on top of the megawatts that Xisto mentioned that is currently working with the authorities right now, provided that we do a lot of proper work from an engineering standpoint we do see a chance that in the future we can eventually ask for additional average megawatts increase which will bring value for each asset of this Company. So I think this is important. And then also depending on lots of work and lots of achievements from both E&P and operations team.

Having said that, I think I will like to close this session of our call and open for questions that you may have.

Questions And Answers

Operator

(Operator Instructions) Bernardo Bresernii, York Jesdon [ph].

Q - Bernardo Bresernii

Just about the issues on Itaqui. And especially on Pecem. Could you just give us some more details about, I mean, what caused them, are they recurrent, when do you expect it to -- for Pecem to be fully operational, if there is any significant costs involved on the maintenance?

A - Eduardo Karrer {BIO 15883150 <GO>}

Sure. Marcus Temke will answer your question. Marcus, please.

A - Marcus Temke {BIO 15883157 <GO>}

Yes. Bernardo what we've been facing in our plants is more related with auxiliary equipment's rather than with the key equipment at the plant. Let me give you some examples. For instance, the boilers, they have large fans which blow air into the combustion chamber. These are important equipment and what we have been facing with them is vibration problems. And also with the actuators, which control the speed and the amount of the fans and there is where we've been having headaches. And working together with the vendors, we have found solutions and implemented. Sometimes, it costs us a little bit of time to fix because you cannot get into an equipment and to do this fix in a single stop. You need to wait and cool down the plant.

So this is why I mentioned in March, we had a longer shutdown in the plants which cost us money because unfortunately the spot price was very high at that time but it's important that sometimes we do those shutdowns and implement the changes and improvements. Some of the work is really under warranty. Some of the improvements we have been making on our cost. But I think what I had mentioned, the message I can convey you, there is -- the cost of this changes or corrections are minor compared to the cost of the impact of a shutdown and then really not significant.

It is an ongoing work. We have been using all the engineering and quality tools. Every problem is identified, go to the root cause. And then there is work plan set up for each of those items with multiple actions regarding mitigation short term and medium term. And definitive solution sometimes takes a little bit longer because you need to buy an equipment or change a spare part and so on. But I think to tranquilize [ph] you, we're not talking about key issues with main equipment's, we're talking about auxiliary equipment which needs to be better addressed. And we are reassessing also spare parts inventory, we are assessing our service providers. So this is the general work which we have already done in Itaqui and of course a lot can be also brought into Pecem, which we're already doing.

Q - Bernardo Bresernii

But do you believe that's like a three months timeframe for you to solve that or it's more a one year or further?

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A - Marcus Temke {BIO 15883157 <GO>}

No. I would say three months or less to get things fixed. And as I also mentioned, we need to take into account in Pecem, we were unfortunate with three external events in the transmission line with the connection to the temporary Cauipe substation where we are connected. So those were events that cost us a lot and every trip then affects the economics because we need to start up the plant T0 [ph] and go through a not so stable condition. The plants, they work very well once they are on T60 [ph]. For instance Pecem plant, they had very stable operations also for a long time. But we had more problems when we start up and with these auxiliary equipment, I mentioned. The mills, some control valves and there is a big support from all shareholders, E.ON, EDP, MPX, local people. So we are doing a big effort now in the same. And I am very confident that we can fix it. And in less than three months.

Q - Bernardo Bresernii

Okay. Thanks a lot.

Operator

Jackson Raphael, JGP Credito [ph].

Q - Jackson Raphael

A real quick with regards to OGX Maranhao, there are a couple of debentures due; they are now going to a short-term indebtedness. Just wondering what's the goal here for the Company in terms of refinancing or rolling the debentures, if you could just give us a flavor what's the current game plan. Thanks.

A - Unidentified Speaker

Thanks for the question. As you know we are only a 30% shareholder in that company. So we are not fully driving that one. Obviously, we take into consideration the overall situation OGX is in, we have to take our share and take care that this will be refinanced. We are currently in discussion with three banks that supports OGX Maranhao in order to come to a solution to refinance the amount that will be due in January. I think we are making very good progress together with OGX to find a solution for that one and most likely we will be able to announce something like in the next quarter call.

Q - Jackson Raphael

Thank you.

Operator

This concludes our Q&A session. We would like to give the floor to Mr. Eduardo Karrer for his closing remarks. You may proceed, sir.

A - Eduardo Karrer {BIO 15883150 <GO>}

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Thank you. I would like to leave you all with the -- our perspective of the Company. I think that we faced it in this first semester, I mean, tremendous challenges. I think no other company in Brazil started 10 plants, or 10 engines like we did in the last many years.

So I think this -- part of what we faced in the first semester is comfortable with the size of the deliverable that we did for Brazil. And to the system. So for sure we need to do better in the future. We are confident that you're going to see the Company in the coming quarters on an upward trend. From an operations perspective, we do have lots of challenges, in the financial front, in the operations front, in the regulatory front, for sure lots of work. But we are confident that the Company has a very positive trend and you are going to see the Company more and more in a good shape in the coming quarters.

So I would like to make myself available, the IR team and all the officers of this Company available for any further questions that you may have. Please call us and we'll be happy to share whatever information you may ask.

Thank you very much for participating today with us here. You have a very nice day.

Operator

This concludes MPX conference call. Thank you, all for joining us. Have a great afternoon. Thank you.

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