

Q2 2007 Earnings Call

Company Participants

- Marc Verstraete, Finance and IR Director

Other Participants

- Eduardo Haiama, Analyst
- Louis Montedo, Analyst
- Sergio Tamashiro, Analyst

Presentation

Operator

Ladies and gentlemen. thanking you for standing by. At this time all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time.

(Operator Instructions)

As a reminder, this conference is being recorded. I would now like to turn the conference over to Mr. Antonio Previtali, Investor Relations Manager of Tractebel Energia. Please go ahead.

under Investors section. Our earnings release can also be found in the Web site.

Before proceeding, let me mention that actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic condition, market risk. And other factors.

With us today in Florianopolis this morning is Mr. Marc Verstraete, Finance and Investor Relations Director. First, Marc will comment on the Company's Second Quarter results. Afterwards, we will be available for a question and answer session. It is now my pleasure to turn this call over to him. Marc, you may now begin.

Marc Verstraete {BIO 18446542 <GO>}

Good morning, to all of you. Thank you for attending this call. I will split my presentation in three parts. First of all, I will briefly discuss on our new energy balance. Second part, I will discuss somewhat on the growth of the Company. And the third part, we will discuss the results of the Second Quarter 2007.

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So if you take our presentation on page eight, you have the scenario of the supply and demand. You have the energy market outlook on the left-hand side of the slide. You can see that until 2011, the supply should still be higher than the demand. And this situation will shift as of 2012 if no new power plants come online.

In the same graph, you can see the increasing price trends. These are the price of the new (end Os) for existing energy obtained at the auctions organized by the government. So you can clearly see that the trend is increasing and we will face higher prices in the future.

On the right-hand side of the same page, you have the situation of Tractebel Energia in terms of uncontracted energy. So you can see that until 2009, the Company is almost fully contracted. We have in 2008, 2010 roughly 5% of our portfolio uncontracted. Then in 2010 we have 9% and this increases to 24% as of 2011 of uncontracted energy of our portfolio. Remaining energy, we will be able to sell at higher prices in the future.

On the following page, you have our energy balance. This is the situation as of the end of June. We have some modification, if you compare this energy balance with the energy balance that we were showing previously. So first of all, on the first slide, the own resources. This is the assured energy attached to our existing power plants. You see that in 2008 this amount decreases. This is because ANEEL will reduce the assured energy, the physical energy, from some thermal plants. In 2009, it increases again due to two new power plants that will come online -- Sao Salvador and Sao Joao. Thereafter I will briefly comment on these plants. They come partially on stream in 2009 and fully in 2010, when we will have 3,175 average megawatts of own resources.

On the second line, you have the purchases for resale, roughly 500 average megawatts this year and dropping somewhat the years thereafter. These total resources are sold through government auctions, auctions of existing energy and of new energy. Existing energy, eight -year contracts; new energy, 30-year or 15-year, where you also have the auction price and the adjusted price for inflation as of the end of June.

And besides the sales through the government auctions, we have the bilateral sales, sales through industrial clients or also old contracts through distribution companies. Today we cannot sell bilaterally any more through distribution companies. But in the past we could. And the difference between both gives us the balance of uncontracted energy, which we also saw in the previous slide.

At the bottom of the graph, you also have the average sales price for 2007/2009 and the average purchase price for the energy purchased for resale. Two comments on -- two additional comments on the energy balance. First of all, as I said, S o Salvador and S o Jo o will start operations in the First Quarter of 2009. And the second one is that we deleted the energy from CIEN. In our previous energy balance, the 300 megawatts, the comfort that we had with CIEN, the energy coming from Argentina was coming back on line in 2009. Now, taking into account the situation in Argentina, we are not so optimistic anymore about this coming back in the year 2009. So we decided to delete it from this energy balance for the time being.

The second part, let's discuss a little bit about growth in the several projects that we are building or developing. On page 11, we have the São Salvador hydro plant. It is now fully owned by Tractebel Energia. Construction started in the Third Quarter of last year and is going fine and the plant should come -- should start operations in the First Quarter of 2009. Remember that the energy is sold through the government auction only as of 2011. So we have almost two years of additional energy to be sold to in the short lines in this case.

The second project that is under construction, it is a much smaller project. It is a 70-megawatt installed capacity thermal plant, which will burn sugarcane bagasse. Well let's say, we set up a partnership with the Dedini Sugar and Alcohol Group, whereby we will build the thermal plant, they will deliver the fuel, the sugarcane bagasse and the water. They will use the energy in their industrial process and the excess energy being 23 average megawatts will be -- has been sold at the 1st Alternative Energy Source Auction at the price of R\$141 per megawatt recently. The plant will start construction in September and it should be ready in April 2009.

The third project we have is Estreito. Estreito is still owned by our shareholder. It is a large hydro plant, 1,087 megawatts. SUEZ owns 40%. And the idea is to sell the energy in the next new energy auction, A-5, which is scheduled somewhere in the -- around September of this year hopefully.

And the last project we have under development is a big thermal plant in the south of the country, in the border with Uruguay, which will burn coal. The plant is located next to the coal mine. It will be a 340-megawatt plant. And the idea is to try to sell this energy to Uruguay who needs energy today. They are burning a lot of diesel oil and so it would be an interesting alternative for them, taking into account that the gas delivery from Argentina is becoming more complicated for them. The total investment cost of this project would be around US\$850 million.

Let's now go to the third part of the presentation which is the result of the Second Quarter of 2007. On page 16, we are showing the net revenues and the EBITDA for the first semester of 2007. So you can see a 8.6% increase as compared to last year for the net revenues and a 2.7% EBITDA increase for the first semester of 2007 compared to the same period of last year. The EBITDA suffered somewhat in this quarter and I will enter into more details briefly.

On page 17, you can see the EBITDA margins. The EBITDA margin was 60% compared to 63% in the previous semester. Then at the end, the net income, the net income last year was positively impacted by the sale of the JacuÃ thermal plant which was a non-recurring item. This year, on the other hand, it has been positively impacted by interest on equity that we declared. So if you exclude both items, you have a 6% increase of the net income over this period compared to the first semester of last year.

If we enter now into the quarterly figures, on page 18 we have some information here comparing the Second Quarter 2006 with this one and also the First Quarter 2007. First of all, you can see that the energy sold remained pretty much stable. On the other hand, the

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average price of the energy increased R\$98 this quarter compared to R\$90 in the previous quarter. And this led to a net operating revenue increase of 10% in Second Quarter '07 compared to Second Quarter '06, the net operating revenue reached R\$731 million.

The EBITDA, on the other hand, decreased both compared to the Second Quarter '06 and the First Quarter this year. The lower EBITDA -- the EBITDA has been impacted by a couple of elements which I would like to detail here. The first one, these are the third-party energy purchased. They reached R\$70 million this quarter compared to R\$60 million in the Second Quarter of '06. Here we have two effects. First of all, we bought more energy for trading. And also as sometimes this energy that we buy for these trading purposes is short-term related, the price is linked to the spot price and the spot price in the Second Quarter of this year increased compared to the Second Quarter of last year. So this resulted in an increased expense of this third-party purchase.

The second part are the transactions at CCEE, they reached R\$91 million this quarter compared to R\$38 million the Second Quarter '06. So a R\$53 million increase. Here we have two elements. The first element is linked to the gas-fired thermal plant, Arjona, which in 2006 was dispatched by the regulator for electrical reasons, meaning that despite the fact that it was an expensive plant, it was dispatched because the city where it is located, Campo Grande, needed this energy and it was one of the only sources of energy they have. In 2007, this is not the case anymore due to transmission lines that were built and so the city -- the region does not need anymore electricity generated by Arjona.

So in 2006, what happened? On the one hand. And so the regulator, (when it) dispatched the plant, meaning that we have the cost of buying natural gas which we will see in the following element, that is the fuel expense. And we also had the cost to run the plant and this cost to run the plant was reimbursed to Tractebel Energia through the CCEE. This generated a revenue of R\$20 million.

So the R\$53 million increase, of course, is explained in part by Arjona, R\$20 million, which is not existing anymore in 2007 and also the PLD price, the spot price. What happened here? The thermal plant -- the dispatch of the thermal plant in the Second Quarter '07 was slower than the dispatch of the thermal plant in the Second Quarter of '06, meaning that we were more exposed and we had to buy more energy on the spot market. So this increased volume, coupled with a higher spot price resulted in a higher expense.

The third point, the fuel expenses, they reached R\$30 million this quarter compared to R\$40 million the Second Quarter of '06. Here we had mainly the effect of, as I already explained, the fact that Arjona was not dispatched anymore and so we didn't need to buy natural gas anymore.

Then the fourth point, the royalties, these are linked to the higher dispatch of the hydro plants and the dispatch of the hydro plants increased 132% compared to the same period over last year. Remember that last year the south of Brazil was experiencing a drought. Not anymore this year. And so the hydro plants were dispatched much more resulting in

us paying royalties. But on the other hand, we cannot forget that we had another effect which they neutralize in this increased royalties expense which is the ERM, Energy Reallocation Mechanism revenues, which are included in the CCEE transactions.

After the EBITDA, we can go to the net income. The net income was positively impacted by lower financial expenses, R\$47 million expense compared to R\$73 million in the same period of last year as a result of lower debt and lower interest expenses and also as a result of the an appreciation of the real compared to the basket of the currencies of our foreign currency debt.

And also on top of these lower financial expenses, we had a lower income tax. Income tax reached 24% of results before taxes compared to 34% last year and the 24% here was the result of interest on equity that we declared in the -- that we accounted for in the Second Quarter of this year, resulting in a net income reaching R\$230 million compared to R\$189 million in the Second Quarter of '06.

Continuing the presentation on the following page, page 19, you have an overview of the debt. Total debt increased. Increased why, because in the Second Quarter we issued R\$350 million bonds to buy SÃ£o Salvador from our shareholder. As a result, the leverage increased slightly. The total debt over EBITDA, which was 0.8, now reached 0.9. And as a result also, the percentage of the foreign currency debt was reduced to 20%. The net debt reached R\$1.2 billion.

On the following page, page 20, we have some information on the CapEx. So here you can clearly see that in 2007, Tractebel Energia is back in investment mode. We have SÃ£o Salvador for R\$304 million. We have the existing power plant for R\$96 million. Then we have SÃ£o JoÃ£o for R\$10 million. And next year, hopefully, we will be able to invest in Estreito also for important amounts. This is only showing, of course, our equity in this project.

Then on the last page, page 21, the good news, the dividend, yesterday the Board approved a 95% payout resulting in a R\$0.69 per share which gives a 3.7% dividend yield for the first half of 2007 or an annualized yield of slightly above 7%.

So this was for the presentation. I would like to open now the Q&A session.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mr. Sergio Tamashiro with Banco Itau.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Hi. Good morning, everyone. Okay, instead of two, I will make three questions. But very quick ones. And the first one is regarding the SÃ£o JoÃ£o thermal plant, I would just like

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to understand how it works. It is new, the biomass thermal plant for us. But I would like to understand about the operational side, if you receive for the current year the R\$141 per megawatt hour and you just operate for, let's say, six months. And during the six months, you are required to dispatch this thermal plant, regardless the hydrological condition. And I would suppose that the hydrological conditions were favorable and the ONS does not require the thermal plant to dispatch. But you are required to buy the bagasse from the sugarcane producers? The part I would like to understand.

The second question is an update on the Rio Madeira project, if you will participate or not, or again under the SUEZ arm instead of under Tractebel. And third is just on the CapEx, you mentioned that CapEx is just for the equity stake, if you could give the total CapEx, including the finances by debt. Thank you.

A - Marc Verstraete {BIO 18446542 <GO>}

Okay. With respect to the first question, the São João thermal plant. So how does it work? The plant. So we have a consortium or partnership with Dedini, whereby we will build the plant, they will give the fuel, the sugarcane bagasse, they will give the water and also the land basically. The energy produced with the bagasse is delivered to them for their industrial process. Also, as already detailed, they are operating the plant and also doing the overhaul of the plant. Then with the sugarcane bagasse energies produced, they use this energy in their industrial process to produce sugar or alcohol. The excess energy is being sold by us, the 23 megawatt average through the auction.

What happens also is that the plant is only operating six months per year because the harvest season lasts six, nearly seven months a year. The rest of the year, the plant does not operate. So the 23 megawatt here is the average over the year and in the six-month period it is higher than that. If they can produce more energy with this plant than the one they will use and the one already sold, this will be shared between both partners. And so if there is more bagasse and if we can produce more, we will share between the partners. This is the way the partnership works.

With respect to your second question, Rio Madeira, okay, as we said, the Group will look at the project. I think yesterday some additional information was received from ANEEL, from the ministries. So it is a project that the Group will look at. We will only be interested in one of the two power plants because having the two power plants in the same region, on the same river, et cetera would be too much of an exposure. Now, you asked me where will it be located, SUEZ, Tractebel Energia, it is still very early to discuss that. I also think that it is a project that we will not be able to do fully on our own. So a partnership will be necessary with other players, being private or state owned. And this is being analyzed for the time being.

With respect to the third question, the total CapEx, I don't have the exact figure here with me. But basically the rule of thumb here is that for this project, both São Salvador and Estreito, the equity portion is around 25% and the rest is financing from BNDES. So doing this short step, you can have the total CapEx. But even so, I will send you the correct figure.

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Q - Sergio Tamashiro {BIO 2274485 <GO>}

Okay. Yes, I will do this math. Just in terms of -- in 2008, for São Salvador, I don't see any portion for the equity stake. Is that correct that they will have no CapEx for São Salvador or all of the CapEx will be financed by debt?

A - Marc Verstraete {BIO 18446542 <GO>}

Yes. What happens for São Salvador is the total investment is R\$856 million. The equity is R\$304 million and that has been already fully disbursed. And now, for the remaining investments, we will count on the BNDES financing. So correct, in 2008, there will be no equity CapEx, let's say, from Tractebel Energia.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

All right. Okay. Thank you.

Operator

Our next question comes from (Mr. Louis Montedo), Credit Suisse.

Q - Louis Montedo

Good afternoon, everyone. I have two questions. In your view, what would be a reasonable energy price with the investments in Rio Madeira project? And the other one, what could be the impact of the increase in exports to Argentina on EBITDA in the second half of this year and at what price are you selling this energy for Argentina? Thanks.

A - Marc Verstraete {BIO 18446542 <GO>}

Well the first question, the price for Rio Madeira, I don't have an idea yet. We don't know the full cost for this project which is somewhere between R\$10 billion and R\$12 billion. But I don't have the math here yet to see at what price we would be interested to build this plant. I think we need some more information and studies before we can answer your question.

With respect to the second question, export to Argentina, impact on EBITDA for the full year, we expect it to be -- as you can see, in the month of June the revenues generated by the export to Argentina and Uruguay were R\$35 million and the fuel purchase, R\$25 million. So we had a very rough -- then you have to do deduct some operational expenses. So slightly below R\$10 million EBITDA impact. We will have two additional months, July, August. So you can -- really a ballpark figure would be around the R\$30 million for the full-year EBITDA impact.

Q - Louis Montedo

Okay. Thank you very much.

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Our next question comes from Mr. Eduardo Haiama with UBS Pactual.

Q - Eduardo Haiama {BIO 7279971 <GO>}

Hi. Good morning, everyone. My first question is just regarding the latest (finished) auction, in which we have a lots of fuel oil thermal plant (swinging) options, I wonder if you could just provide a general view on what you expect for the next New Energy Auction. This will be provided scheduled by, I don't know, September/October and if you believe that the fuel oil is still going to be competitive or do you believe like the federal government will somehow provide more competitiveness for gas-fired thermal plants or maybe coal thermal plants. That will be my first question.

And the second question is also related to just thermal plant contracts. If you believe like if the federal government continues to buy from thermal plants instead of hydro, if you believe that we should expect much higher spot price in the medium term, then what would be (inaudible) case, if they acquired more hydrothermal plants. Those will be my two questions. Thank you.

A - Marc Verstraete {BIO 18446542 <GO>}

With respect to your first question, for the next auction, in the previous auction, which was A-3, the next auction will be A-5. So we -- hopefully, we will see some hydro plants, especially Estreito entering in. We also think that the fact that no hydro plants participated in the previous auction was mainly a signal that the cap was too low and so that we could see higher caps for the next auction.

Now, with respect to competitiveness of fuel oil, if it will increase or not, I don't have a specific view on that. Your second question was not totally clear to me. Part of the question was --

Q - Eduardo Haiama {BIO 7279971 <GO>}

Okay. Basically, like if they are acquiring more thermal plants, my view is that we should expect much a higher spot price into the futures if they continue with this policy of buying thermal instead of hydro, I would just like to have your thoughts regarding this scenario, or if you believe like they are going to be able to change the scenario and buy more hydro in the future.

(technical difficulty)

Operator

Excuse me. Tractebel's conference has been interrupted for technical reasons. Please hold on and we will soon resume the conference call. Thank you.

(technical difficulty)

Q - Eduardo Haiama {BIO 7279971 <GO>}

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My question is basically like, if you can just provide what is your view regarding --- how the government is really going to -- what they could maybe in the future to change the auction to contract more hydro power plants because today with the scenario of acquiring more thermal plants, my understanding is like that we should expect much higher spot price in the future. And I would just like to know if you believe like we might see some change in future auctions to give more competitiveness to the other thermal plants and what is your view regarding then on long-term spot price?

A - Marc Verstraete {BIO 18446542 <GO>}

We do agree with you. I mean, the fact that the government is injecting more energy coming from thermal sources in the system, it is going to impact upwards the spot prices, although this impact is of course lower than if we have no expansion at all. So we do agree. There seems to be a clear chance that spot prices are going to go up unless, of course, you have more hydro plants come into play. And we are anxiously waiting new opportunities on the hydro side. But unfortunately these opportunities are not coming for the time being. But you are right in your thoughts.

Q - Eduardo Haiama {BIO 7279971 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) This concludes today's question and answer session. Mr. Marc, at this time, you may proceed with your closing statement.

A - Marc Verstraete {BIO 18446542 <GO>}

Well I would like to thank all of you for your attention. I remind you that we remain at the disposal here. Antonio Previtali, his team. And myself for additional questions and also for the one of a few who are in Brazil. Tomorrow morning, we will be in Sao Paulo at the (inaudible) meeting and tomorrow afternoon in Rio. Our CEO will be there as well. So if you are able to join, it will be a nice opportunity to share some thoughts with him on the Company or even the market as a whole. Thank you very much. Bye.

Operator

That does conclude our Tractebel Second Quarter results conference call for today. Thank you very much for your participation. You may now disconnect.

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