FINAL

Q1 2012 Earnings Call

Company Participants

- Mario Arruda Sampaio, Head of Capital Market and Investor Relations

Other Participants

- Michael Gaugler
- Márcio Prado

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone

to SABESP Conference Call to discuss its Results for the First Quarter of 2012. The audio for this conference is being broadcast simultaneously through the Internet on the website www.sabesp.com.br. On that same address, you can also find the slide show presentation available for download.

We inform that all our 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. [Operator Instructions].

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

Today with us we have Mr. Rui de Affonso, Chief Financial Officer and Investor Relations Officer, Mr. Mario Arruda Sampaio, Head of Capital Market and Investor Relations and Investor Relations and Ms. Nara Maria Marcondes França, Head of Accounting.

I will now turn the conference over to Mr. Arruda Sampaio. Sir, you may begin your conference.

Bloomberg Transcript

FINAL

Bloomberg Transcript

Mario Arruda Sampaio

Okay. Thank you. Good morning everybody. We will right now go through our first quarter 2012 earnings.

We have couple of slides here to discuss the main event. Let's jump start to slide three, we will -- here we will discuss billed volume and water losses. We have a positive performance in the volume, water and sewage volume. We're 3% up from the same period in 2011 obviously as an aggregate. The increase in billed volume is due to the increase of 2.6% in water connections and 3.6% in sewage connection. This is in line with expected growth of approximately 2.5% to build water volume and 3% to 3.5% and build sewage volume.

The last as you all know and have kept track it, influenced by the company's very large investment in sewage treatment in the metro region of São Paulo and the metro region of --.

The water loss ratio as you can see, we made literally stable in relation to fourth quarter 2011 with a small increase, actually an increase in water loss of 0.1%. When we compared to first quarter on a quarter-to-quarter basis from last year, we see a reduction of 0.5% from 26.2 to 25.7. So it doesn't change the trend of reduction.

Let's move now to financial highlights at slide four. Net revenues was positively affected by the 6.82%, an increase at September 2011 and the 3% growth in billed volume as mentioned in the previous slide. Cash and expenses increased by 0.4 in the period yet as a percentage of net revenue, cost and expenses moved from 81.4% in first quarter '11 to 72.7% in the first quarter 2012. EBITDA increased from R$664.3 in first quarter '11 to R$880.2 million in the first quarter of 2012. The EBITDA margin came down -- came to sorry, to 34.5 above 28.5 in first quarter 2011, and this includes the construction cost and revenues.

EBIT up by 64.6% from 426.2 million in first quarter of 2011 to 701.7 million in first quarter of 2012. Net income increased 169% from 182 million to 491 million in first quarter 2012. This variation is in great part explained by some relevant, nonrecurring events.

In the first quarter 2011, the two major ones were, first, recognition of R$ 157 million an actuarial liability event. And the second, the adjustment of the terms of the amortization of assets especially the intangible assets related to the service contract agreement with the Municipality of San Paulo in the amount of 73 million. So in fact, the 2011 first quarter was highly impacted by nonrecurring event. Then if we exclude the two effects, the first quarter of 2012 net income increase was yet still very good, 27.1% over the first quarter 2011.

Let's now move on to slide five. In this we'll discuss and highlight of main regulations in cost and expenses in relation to the previous quarter. In comparison to with the first quarter 2011, there was a 0.4% upturning cost and expenses mostly due to the increase of 31.6 in general expenses, 27.7 in tax management, 12.2% in credit write-offs, 14.5% in

FINAL

Bloomberg Transcript

services and 22.8% in construction costs. And we also highlight 27% decline in payroll and pension.

In fact payroll and benefits fell by R$ 150.2 million from 556 million to 406 million, and this again was mostly due to the R$ 157 million first quarter nonrecurring provision we mentioned previously related to the zero actuarial liability pension plan. Also contributed to the favorable variation, a 440 reduction in the work force in the period, and this is related to the retirement plan that is associated to what we call the tax which is the Conduct Adjustment Agreement between the company and state prosecutors. This actually almost concluding, we still have further the dismissals under that contract, but this is pretty much concluding moving up to the very close to conclusion of that reduction in retirement plan.

Moving to general expenses, that climbed 40.3 million or as mentioned 31.6% from 127 million to 167 million, -- products rate 36 million increase in the provision for legal contingencies over first quarter 2011, and 6 million increase related and explained by the higher revenue in providing services to the city. In other words the 6 million is an increase related to the 7.5% transfers of fund we do on a quarterly basis to the municipal infrastructure and environmental fund in accordance to our contract to provide service for then actually. So in other words, we sold more to the citizen and thus that increases the base of the trend.

Tax expenses moved up by 7.6 million or 27.7 million due to the municipal tax, what we call the land tax, called in Portuguese words -- and especially land tax towards the city of São Paulo. Restructuring cost went up due to higher levels of investments in the period. Credit write-offs increased 5.7 million or 17.2% from 33.1 million to 78.8 million mostly due to the higher provisioning for public entity.

Services increased 33.6 million, or 14.5% from 231 million to 265 million. This is due to a couple of points here and service related to the classification of water loss prevention initiatives. Radio and TV advertising campaigns focus on social and environmental initiatives such as the sustainable planet and we call project of the row which is summer project. At the point, there is an increase in debt service payment related to the public and private partnership agreements of the -- water production system, since there was start up an increase in production capacity from 10 cubic meters per second to 15 cubic meters per second.

And last, there is a fleet renewal program ongoing where the company is moving from owning the vehicles to leasing them. This should bring benefits to us as we do the math as well our cash requirement for fleet acquisition and our cost for maintenance, fleet management and vehicle related taxes and expansions such as ownership taxes, licensing, et cetera.

Let's move now to the next slide. Let's talk about the items that affected net income. Net operating revenue moved up by 283 million or 12.3% for the same period in 2011. That's mostly due to 3% of current in billed volume, also a 6.82% tariff adjustment as of

FINAL

Bloomberg Transcript

September 2011, and increased construction revenues following higher investments in the period.

Costs and expenses varied 6.7 million or 0.4% and that is well below revenue growth. Other operating revenue, that is net of expenses increased 4.5 million due to the recognition on our accrual basis. But part of the funds that we received from the state of São Paulo Government as we adhere to the Alienation of Exclusivity Rights for deposits of SABESP's employees' payments from March to March 2007 with Nossa Caixa and Banco do Brasil. And this can also -- revenues obtains from contractual fines with suppliers.

Net financial revenue and expenses had a 95.7 million positive impact in net income, variation between the periods. This was mainly due to the 9.05% depreciation of the riyal against the yen. As mentioned by one of the analysts with a lot of help from Japan then in first quarter versus 4.3% depreciation in first quarter 2011, and a 37.9 million reduction with interest payments on domestic loans and financing due to the amortization of the eight and ninth debenture issuance in June and October 2011. And the other side of this, it was in part -- by higher finance expenses related to losses in the amount of 23.7 million. Finally, income tax and social contribution impacted negatively by 57.4 million and that is due mostly to the increase in the taxable thing.

Let's now move to our last slide, and let's talk about our long-term low cost funding and how are we in the process of further -- liquidity for the investment plan. As you know, the Ministry of the Cities has been approving public long-term cost, financing for several Sebastião's projects at the beginning of the year and end of last year. In February this year, the company contracted 30 credit operations with the cash -- that is the social bank totaling 134 million which will be allocated to water supply and switch works and services as well as service and projects. That benefited regions is mostly done by shutters and -- As an example there is is between those areas in metro regions in São Paulo. These cases were talking about loans paying interest rate for 6% plus risk rate of 0.3 and administration fee of 1.4 which is about 7.7% total plus -- made which anywhere close to at 1% here.

The grace period is up to four years or 5% is water of sewage and the total period for amortization is 20 years.

Moving to the next, we in March, signed in two contracts, financing contracts totaling R$ 181 million, price BNDES, the development bank. This is mostly directed to the execution and sewage systems expansions in the metro regions of São Paulo and also to prepare the executive project for the next big water expansion in the metro region of São Paulo where we called here as -- water production system. This loan, these two loans have a total tern of 180 with grace periods about 24 to 36 months, and the interest rate is that the NDF TJLP long-term interest rate of 6% plus a spread of 1.72%, which includes center of the administration and the risk.

And again, what is important then to highlight that these approvals and contracts further guaranties that funding availability and that the liquidity for the company continued

FINAL

Bloomberg Transcript

progressive and very important investment plans and the quest to improve service coverage and achieve full coverage by the end of this decade.

So that it concludes these initial remarks. And we would like to open for questions-and-answer as of now. Thank you very much.

Questions And Answers

Operator

We will now begin the question-and-answer session. [Operator Instructions]. Our first question is from Michael Gaugler from Brean Murray Carret.

Q - Michael Gaugler {BIO 7139923 <GO>}

Yes. Good morning everyone.

A - Mario Arruda Sampaio

Good morning Michael.

Q - Michael Gaugler {BIO 7139923 <GO>}

Mario you did a nice job outlining the debt profile and what's your thinking is. One question that was raised in my mind was you anticipated keeping the rate of domestic versus international as same going forward, or does it change, I mean right now, I think it's a little, it's quite around 70 domestic/international. Is it -- more of that domestic now or does it more international?

A - Mario Arruda Sampaio

Well Michael, our tax exposure, if we -- let's say if all the reds of the variables for example kept constant, we expect a decrease as we go through time and time being from now to the next four years to five years. And the basic reason for that is that we will be taking more international long-term funding then we will be amorziting in the period. So it's the fact, if anywhere close to 30% now, you can expect all that constant and additional FX exposure in the future.

Now, I would like to comment on that is that we have total debt and the debt profile as you can see to -- and which we -- very much having them, but we can't, in the long run, in the 21 call it as 2015, we have a call option on this. So at the same time, the 2016 bond is a $140 million bond that we have done before and we may do again, anytime soon or whenever a tender offer on them. But in other words, we have a pretty much good liability, debt liability position if we want to reduce and change that debt into local debt without hurting too much the debt profile.

In fact, if we continue to see very long, the improvement in the local interest rates and we think the liquidity continuing in Brazil as this professionally for our company. I am not saying we're going to do anything, but it becomes attractive to think about doing some

FINAL

Bloomberg Transcript

liability management there, and potentially seeing where the exposure can be reduced to accommodate this new and then we will have some options in terms of that further exposing the bottom-line, okay.

Q - Michael Gaugler {BIO 7139923 <GO>}

Okay. Then I only had two more questions, the next one. Just wondering at water supply and how the levels are in the reservoirs right now?

A - Mario Arruda Sampaio

Okay. Well, let me ask here Angela, where is the water supply? I kind of we keep track here Michael. And we are obviously moving into right now the dry periods. I don't have specifics on where the reservoir's levels are. I do know that we don't see major, I will concern. I mean Angela is -- the levels we have at the -- the big pictures from around here and it's actually more than 70% of the water supply for the metro region.

And not even a yellow light there. So, I think we did well replenishing and to help us the weather is very cold. To help us in terms of less water consumption, but not on the good side revenue, nothing's perfect. But the reservoir levels are fine.

Q - Michael Gaugler {BIO 7139923 <GO>}

Good to hear. And then my last question, on the regulatory environment, any new developments in terms of establishing the asset base for -- purposes or anything else that might be lower than with regard to our system and so the process.

A - Mario Arruda Sampaio

Well, okay. I am going to put you on hold just to get one or two more specifics here. We may be just help provide better answer, so please hold a second. Just one more second, two more points here to share with you guys. Just one more second. Okay, sorry Michael and rest of the audience here.

Let me jump in.

I think first, the good -- I think we are fairly good news from all perspective. First is that, everything is on track, there is absolutely from the company's standpoint, and from a lot of perception, there is nothing that guides us not to for us and SABESP to deliver the schedule. They have proved out with the last schedule, so I think that's good news, we are moving on the regulatory asset based estimation and according to the time line, we have to deliver that in August 30, and we will. I got the information, we're doing well then.

Now, something did happen in terms of developments and as you all know, and Michael showed us a public audience on the full methodology. The methodology that regulatory agency put out for public audience, I believe in early February, there was a public discussion, but that's be made several comments. And I think, so I was pretty much taking out of the, let's say like the five which we think are the most relevant to share with everybody.

One of them not so positive. Originally we have asked that cycles, revision cycles would be five years, which again would help take the revisions from a different year in terms of election year. And also giving that the revision are very complex, especially because we have to always estimate the value of the asset base that would give more time for that to happen, that unfortunately was not accepeted, it was kept at four years. But with something that is positive was accepted.

We may request, we could have at any time an extraordinary revision. Originally just as an example, they mentioned that extraordinary revisions would be possible at any time. As long as such items would reach such value, example, xchange rates variation above 30%, then we could have a revision, which is something not interesting.

So the fact, the good news is that we can ask revision at anytime for any reason. So going back to your FX question, it's basically, if there is some immediate, quick variation in dollar that could potentially hurt and put the company in a not balanced for, we go immediately and request for a discussion around a revision to compensate to that. So that is mitigating also our FX exposure from my perspective. Also, the X-factor to be applied during this first four years will be not greater than 2% for the total period. So it's pretty much operational efficiencies have to happened to 2%. Anything above that will be going for the bottom-line.

Other point is that the strictness in terms of following the quality factor, we only be applied after second year, so in three years, three, four that this is time to adequate our overall systems to comply, and it's something that was left out of the formula was included which is the allowance for doubtful accounts. So, in summary those are the key points that we highlight that the current stage of the regulatory framework, okay.

Q - Michael Gaugler {BIO 7139923 <GO>}

All right. Thank you. I'll let somebody else ask a question.

A - Mario Arruda Sampaio

Thanks Michael.

Operator

[Operator Instructions]. At this time we do not have any further questions. I'm sorry. Our next question comes from Márcio Prado with Santander.

Q - Márcio Prado

Good morning Mario. Good morning everyone. This is Márcio Prado, Santander. Mario, just would like to ask you with regards to the operating costs of -- a general view. We have seen the company with costs pretty much under control over the last 12 months to 18 months. I know there were some recurring that's favored the operating cost comparison between the first Q 2012 to the first Q 2011. But annually over the last 12 months to 18 months, we have demonstrated the operating costs pretty much in control. So, I would just like to hear from you, if this controlled operating cost. If there has any major reason

FINAL

behind that. First talk a little bit about the layoff problem in the past and how do you see operating costs for -- evolving from now onwards? Thank you.

A - Mario Arruda Sampaio

Okay. Márcio I will start commenting fully or anybody else in the group, if you have anything to add, you just look at me and interrupt. But I understand that operating cost pattern that you just mentioned is actually the result of a work that was early and that began in 2007 when we launched our investment plans. At that time, we -- if you recall, we said we will reduce and control energy costs. We will control further control and reduce efficiencies in terms of water loss which has significant impact in several aspects of our business.

And we will reduce and fulfill -- not fulfill -- reduce the total actually not headcount only, but total payroll amount. And I think what we are delivering, that's the point. We are delivering. So if we go, if we move forward and lastly if we are going to have layoffs, we are adding a lot of capacity, we are adding a lot of assets to be managed. I think the company is obviously looking at well-balanced headcount and I would not say there will be layoff as we've moved forward, may be what we need to do is to make sure that we keep where we are and do the improvements that we can't, that's one point.

The last point you said about the future. Can you repeat it because I pretty much didn't manage to take the note Márcio. What was the last?

Q - Márcio Prado

Basically Mario is that given these costs under control as you mentioned a product of -- new started Internet in '10, how do you see this involving into the future. I mean additional cost cut measures or should we expect costs now to increase more line of inflation or a little bit higher than that. Basically how do you see this cost control -- in the future, in the near future, for SABESP in the next few years?

A - Mario Arruda Sampaio

Okay. Let's put it this way, looking at to head a regulation - is going to look at me in that. But the point is, if as of the 30th of November, role for the methodology to establish the tariff and efficiency is that we need to prove efficiency on the OpEx by 2%. For sure, we're going to work to reach less than -- more than a reduction or further than 2%. The question is, if we have, how to do that? I think there is always ways and the company is always looking at ways to improve. One way is to further and continue improvements in the water loss program.

Should we call, we have the challenge put to ourselves and now that we will have to or would be some from committing with the regulator to take water loss reduction. Let's say central economy level which is about 13%, 14% loss. All those movements, all that will create more efficiency and will help us sustain the margins and the generations we are showing now.

Bloomberg Transcript

I think we have not reached the valley, if your question is that. There is lot of, we can see a lot of duplicate functions in this company. We have studied around that, which means that we potentially have gains in terms of reduction functions. There is a lot to do as we move forward and to -- but again the challenge is to keep the margins up where they are such that we can keep the leverage going and the investment going.

Q - Márcio Prado

Great. Thank you Mario

Operator

[Operator Instructions].

Q - Márcio Prado

Okay everybody, thank you for your time and availability. As you all know, there will be a Portuguese call further on today, so you are guided to join. We'll be back in August with the second quarter numbers and that's it. Thanks a lot. Any questions, call the IR area. Bye bye.

Operator

The conference has concluded. You may now disconnect.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL
Bloomberg Transcript