Q1 2015 Earnings Call

Company Participants

- Eduardo Haiama, Chief Financial Officer, Investor Relations Officer

Other Participants

- Henrique Peretti, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to Equatorial Energia's First Quarter of 2015 Results Conference Call. With us here today, we have Eduardo Haiama, Chief Financial and Investors Relations Officer. This event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After Equatorial's remarks, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions) This event is also being broadcast live via webcast and may be accessed through Equatorial's website at www.equatorialenergia.com.br, where the presentation is also available.

Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via the webcast may post their questions on our website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Equatorial's management and on information currently available to the Company. They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Eduardo Haiama. Mr. Eduardo, you may begin your presentation.

Eduardo Haiama {BIO 7279971 <GO>}

Hi, good morning everyone. First of all, I would like thank you all for joining us in our first quarter conference call. As per agenda for today, which you can see on slide two, I'll start the conference call describing highlights of this quarter, then I'll comment our operating and financial results, later we'll comment on some corporate updates for the quarter. And finally, we will open the Q&A session.

Before the highlights, I'd like to clarify some procedures regarding the figures presented in this earnings release and in this presentation. I'd like to point out that consolidated information reflects 100% of CEMAR's, 100% of CELPA's, and 100% of Equatorial Solucoes, which in turn consolidates 100% of Sol Energias' figures.

Moving on to slide six. In this quarter, both CEMAR and CELPA posted another good energy demand growth respectively of 5.8% and 4.6% year-on-year. First quarter, CEMAR's net loss remained flat at 17.7% of the required energy, and in CELPA total losses continued to drop and reached 30.8% of the required energy. Again, CELPA presented significant improvement in both quality indicators DEC and FEC in the quarter.

Moving on to slide seven. Net operating revenue reached BRL1.7 billion, or a 26% higher in the first quarter of 2014, basically due to the approval of regulator assets, tariff adjustments last year in the beginning of the tariff flag mechanism.

Adjusted EBITDA was BRL215 million or a 6% increase year-on-year. In the quarter, Equatorial presents an adjusted net income of BRL15 million, compared to BRL91 million in the first quarter of '14. Consolidated investment totaled BRL324 million or 53% higher than last year, mainly due to the increase in CELPA's investments.

Moving on to slide nine, we talk about the electricity market in CEMAR. In CEMAR, as we can see, energy demand posted a 5.8% growth in different segments, mainly a result of the 2.9 expansion on the client base and the increase per capita consumption in the period.

Moving to slide 10, CEMAR's losses remain flat at 17.7%, still below the regulatory targets set by ANEEL valid [ph] until August this year of 19.2%. Non-technical losses over a low-voltage market reached 12.4% in the quarter, also below the 15.6% defined as regulatory targets set by ANEEL. As we have already been saying, during the low energy losses, already reached by CEMAR, its natural to expect some kind of accommodation in the short-term, while we reassess our loss combat program to see what should be the sustainable level in the long-term.

Moving on to slide 11, in terms of quality indicators, DEC increased 6% year-on-year, amounting to 17.1 hour, and the FEC had a slight improvement of 0.8%, amounting to 10.4 times. It's important to mention, we have already revised some internal per shares regarding specialties at DEC in order to continue to improve both quality indicators going forward.

In CELPA, we move to slide 12. distributed [ph] energy grew by 4.6% in the quarter, basically explained by the further reduction in losses. By the increasing in the number of new consumer of 6.7% compared to the first quarter 2014.

On slide 13, the company continued to post the reduction in losses reaching 30.8% or 0.4 percentage point reduction compared to fourth quarter '14. In terms of non-technical losses, we have reached 42.4%, still a reduction of 1.3 percentage points in the quarter. It's worth highlighting that we are now in our sixth consecutive quarter in terms of loss reduction since we started our Loss Combat program by the end of the third '13.

Moving on to slide 14, DEC and FEC continued to significantly improve by 27.5% and 17.3% respectively, reaching 47 hours and 29 times. As you can see in the graph, since third quarter '12, the quarter we acquired the company, we have reduced DEC and FEC by 54% and FEC by 43%. It's important to highlight that improving quality service indicators is one of our core goals since we got the control of CELPA. And this improvement is a result of change in some internal procedures, and also all the investments have been made in the grid since we took the control. It's also important to stress that since first quarter '14, we have achieved ANEEL's goal in terms of FEC indicator.

On slide 16, first quarter EBITDA by IFRS standards amounted to BRL247 million. It's worth mentioning that starting this quarter we approved all fines paid to consumers in the operating expense line, and until fourth quarter '14, we recorded [ph] these fines as financial expense.

As non-recurring effect in this quarter results, adjusted EBITDA would have amounted to BRL215 million, or an increase of 6% compared to the first quarter '14. We remain that with the Group net regulatory assets as from this quarter we should no longer observe difference between IFRS and regulatory EBITDAs.

The non-recurring effects in CELPA's results, we highlight a positive approve [ph] of BRL58 million related to the reduction of the fines paid to consumers since we took control of CELPA. This positively impacts our other expense under the (inaudible) expense.

There is also the high energy purchase expense in the quarter due to the injunctions of CCEE, but preliminary results according [ph] to corresponding regulatory assets. It's also important to mention that this improvement in EBITDA continues to reflect the turnaround being implemented at CELPA, that's both on operational and financial performance. And in the case of CEMAR, basically due to the main growth and also cost control.

The next slide, consolidated net income amounted to BRL85 million compared to BRL15 million in the first quarter, adjusting by the non-recurring effect, already mentioned in the previous slide, and also by CEMAR, that impact depreciation and also financial results and operating results. Adjusted net income would have reached BRL15 million compared to BRL91 million in the first quarter of 2014.

On slide 18, we present debt amortization schedule of the company. As you can see, we have already rolled over a significant amount of short-term debt that was in CELPA this year. So now the schedule is next year and the year after. Gross debt amounted to BRL4.4 billion being BRL2.3 billion in CELPA and BRL2.1 billion in CEMAR. And by the end of first quarter, consolidated net cash position of Equatorial of BRL1.7 million was considerably bigger than the company's consolidated short term of BRL420 million.

On slide 19, we breakdown Equatorial's consolidated net debt, which amounts to BRL2.1 billion, excluding net regulatory assets, consolidated cash position, and swaps. And as a result, net debt to EBITDA last 12 months amounted to BRL1.9 times. Part of this increase is related to the CapEx, the high CapEx level at CELPA in the first quarter, and also as a small percentage by the devaluation of the Brazilian currency for the very long-term US dollar debt that we have, that we don't have a hedge for that, but it's a small component of our total debt.

If adjust net debt in proportion to Equatorial's stake in CEMAR of 65% and CELPA 96% as shown on slide 20, we've reached BRL1.7 billion of net debt, representing two times net debt to EBITDA.

Moving on to slide 21, represent our CapEx figures. The main highlights would be for CELPA that we had increased by 83% and from now on you should expect a lower rate of increase and maybe even a small decrease after this big investment we have made to improve the quality indicators of the company in the past two years.

So now, we believe we can start the Q&A session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Henrique Peretti, J.P. Morgan.

Q - Henrique Peretti {BIO 18446440 <GO>}

Hi. Good afternoon, Haiama. I have two questions here. The first one is regarding energy sales volumes. Do you have an idea of demand this year for CELPA and CEMAR? I thought that the pace of growth declined sharply vis-a-vis [ph] fourth quarter and third quarter. Is it related to the recent package of tariff increase that the government implemented? I know that the tariff increase -- the extraordinary tariff increase in the north and northeast was much slower than what has happened in the Southeast. So if you could give us an idea of how much to expect for growth at CEMAR and CELPA this year?

And the second question is regarding the technical note that ANEEL released regarding the first tariff review. So do you have an idea, any read-through [ph] for CELPA and for CEMAR, or do you have an expectation or any news on the OpEx, on the curve for energy losses for CELPA? If you could give us any color on the CELPA tariff review that should be (inaudible)? Thank you.

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Henrique. Regarding sales volume, it's hard to say if this reduction in (inaudible) relates the tariff increase because it was in August. Starting this year, the tariff flag plus the action of that tariff view has an additional impact of about 15%, 16%. So on top of the last year tariff increase of 35% in CELPA and 25% in CEMAR. We are talking about total tariff increase of 40%, 50% since August.

But it's hard to say if it's related to that, even that we still have a very low consumption per capita in both companies relative to any kind of revenue you might (inaudible) Brazil or other parts, or if it was related to the weather that has an impact now in terms of seasonality in both companies, or in the third case, especially in CELPA, to the loss combat program because you need to remember that whenever we are successful in terms of reducing losses, generally, the consumers will have some issues regarding the consumption once we fix the problem. And they have to pay the full consumption, generally what happens with this consumer, they reduce their actual consumption, thus that could have an impact in terms of overall consumption in CELPA, even though it's like (inaudible) losses.

Our view is like, this first quarter, regarding CEMAR, you should not expect pick-up in terms of demand from the level should be -- maybe this level a little bit higher than that, but not by much. And as for CELPA, given that we, in CELPA we do have a more than (inaudible) industrial clients that we have. For example, in CEMAR, we believe like that we should expect some pick-up in demand probably in the second half.

And also due to this weather-related that has some kind of impact because we know that it rain a lot, especially in the main part of the concession where it has the biggest consumption that is in depth translating to less use of our air conditioning. But in the second half, we don't have this issue. It's of a much less than that. So we believe like I should expect some kind of demand pick-up in the second half in CELPA.

Regarding your second question, well, just in the first part, do you have any doubt?

Q - Henrique Peretti {BIO 18446440 <GO>}

No, no, it's very clear. Thank you.

A - Eduardo Haiama {BIO 7279971 <GO>}

Okay. So, regarding the second question regarding the fourth tariff review cycle, we believe like -- the good movement that the regulators provided was to review the methodology regarding allowance for doubtful accounts. So the delinquency rate in our case increased compared to the third cycle, and I believe like that reflects the complex of these concessionaires that the regulator putting to the methodology, so it was very important.

As for the other components of the tariff review methodology, we have -- we know it's like a very small change, so it's not like a big change from what they have announced previously. So in our view it's not like a material change in that sense. So we believe like -- sorry.

Q - Henrique Peretti {BIO 18446440 <GO>}

Even in the case of the energy losses that should take into account the average energy loss (inaudible) cycle --

A - Eduardo Haiama {BIO 7279971 <GO>}

That was already in the previous methodology, right?

Q - Henrique Peretti {BIO 18446440 <GO>}

Okay.

A - Eduardo Haiama {BIO 7279971 <GO>}

Not the third cycle, but the one when they propose. They're still proposing, that is the (inaudible) average. So that's what I am saying, in terms of the (inaudible) in terms of the third cycle, sure. I believe like that was an important change, because basically you are (inaudible) reduce losses and also for a company that have already reached the very low level, not to be -- and that's right. So you should put -- it reached a very low level maybe by luck, right. But it was a pure luck and then whatever you're going to be have a very low loss level, and you're never going to be able to reach again. So in a sense I believe like the regulator was very sensible in this sense.

In the case of CELPA, and that's why I was saying that it wasn't a big change, because it was already there in the methodology, room for that and they just approved that. That they would give the possibility for very complex concessionaires to apply for different methodology (inaudible) loss targets. In a sense, meaning that instead of applying the average of those loss levels of the previous cycle, the target you would be able to set a different starting point for loss level.

In our view, it's very important because when you start dealing with very complex concessionaires, it might be the case the methodology doesn't capture the real defeat of the combat was in these regions. And once they set the target, the way that the methodology was set before, no matter if the regulator only put these targets flat forever. Given the complex of this region, you would never be able to achieve. So in a sense, they create this flexibility for the very complex concessionaires.

It's also important to mention that they not only create for the -- complex concessionaires, but also for concession they not necessarily the very most complex ones. But also has some increase or some other fees that they can explain. So that you would not be like that in a track of having a much lower target than a possible. But given that this discussion was already been (inaudible) at least in our view, including in the previous proposal, that's why I didn't mention specifically regarding losses.

Overall, we believe like the regulator, they have clearly giving the signal that the third cycle was very tight condition for the companies. And given all these macro conditions that we have in Brazil for high interest rates, very high tariff increase, lower demand growth, they need to provide room for companies to recover their profitability. So that the sector as a whole can be sustainable. So that's our view. I think like that was a very strong significant regulator that they want to be still like the sector will not face again any difficulty going forward.

So for CELPA, probably we're going to have the public hearing starting next week. We still don't know this schedule is on time or not, it got to be delayed for some reason. But supposedly, considering the official schedule, the new figure should be released next week for the preliminary figures for the tariff review.

Q - Henrique Peretti {BIO 18446440 <GO>}

Okay. Do you have any idea how much money represents the remuneration of the special obligation?

A - Eduardo Haiama {BIO 7279971 <GO>}

It should be roughly about 1.5% of the gross special obligation approximately.

Q - Henrique Peretti {BIO 18446440 <GO>}

Then what is the number for -- do you have the number for CELPA and CEMAR here now?

A - Eduardo Haiama {BIO 7279971 <GO>}

Well, if you get our accounting figures, it would be about like 20 highs [ph], close to BRL30 million.

Q - Henrique Peretti {BIO 18446440 <GO>}

Okay. Thanks, Haiama.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Eduardo to proceed with his closing statements. Please go ahead, sir.

A - Eduardo Haiama {BIO 7279971 <GO>}

To sum up, we'd like to reinforce our commitment delivering a differentiated percent to our shareholders through exceptional financial operating results. We would also like to highlight over the years to the highest level of transparency in corporate governance and reassure that both me and our Investor Relations team are available to help you should have any further questions. Thank you all again for taking part of our first quarter conference call, and have a good day.

Operator

That does conclude Equatorial Energia's audio conference for today. Thank you very much for your participation. Have a good day.