Q2 2018 Earnings Call

Company Participants

- Flavia Heller, IR Officer
- Lino Lopes Cancado, VP E&P Division
- Pedro Zinner, CEO, Chief IR Officer & Member of the Executive Board
- Unidentified Speaker, Unknown

Other Participants

- Bruno Pascon, Equity Analyst
- Thiago Silva, Research Analyst

Presentation

Operator

Good morning. And thank you for waiting. I welcome you to the ENEVA teleconference to discuss financial results of Q2 2018.

With us today we have Mr. Pedro Zinner, CEO and Investor Relations Director; and Flavia Heller, IR Manager.

This event is being recorded. (Operator Instructions) This event is also being transmitted simultaneously via webcast and may be accessed at ri.eneva.com.br and also at MZiQ platform where the respective presentation is available. The slides are controlled by you. Replay will be available immediately after the end of this event. We kindly remind you that the webcast participants may submit questions before the conference via website and will be answered during the Q&A session.

Before proceeding, let me clarify that any forward-looking statements made during this teleconference regarding any business perspective, forecast, operational and financial targets are based on the management's expectations for the future of the company as well as on information currently available. These forward-looking statements are not a guarantee of performance. They involve risks, uncertainties and premises that may refer to future events and therefore depend on circumstances that may or may not take place. Investors and analysts, please keep in mind that overall conditions that affect the specific conditions and other operational factors may affect future results of ENEVA into these results that are materially different from those expressed in such future conditions.

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

Pedro Zinner {BIO 17260844 <GO>}

Thank you very much. Good morning. Thank you for participating in this earnings conference for the Second Quarter in 2018.

Today, in this call, I have some members of the Board of Directors among them (inaudible), our operational representative; and Andrea Azeredo, our CFO.

Before starting, I'd like to ask you to pay attention to Slide 2. Then moving on to Slide 3, we're going to start our presentation. We closed the Q2 2018 with an adjusted EBITDA of BRL 307 million, reflecting operational improvements in coal generation and also the greater contribution of the gas complex in ParnaÃba. Total net generation reached 1.3 gigawatts, with a 21% (sic) (31%) increase in gas generation and a 19% reduction in coal generation. The greater energy volume produced by the gas generation segment, in line with our anticipations, generated a production of 0.2 Bcm of gas.

The hedging strategy results, ADOMP, also contributed to reduce the impact of penalties. And therefore, we had a BRL 10 million gain.

The operating cash flow reached BRL 237 million, representing a reduction of 18% when compared to Q2 2017 and faced with a greater need of capital.

The company reported a net income of BRL 127 million in the face of a loss that was reported last year. We're going to discuss throughout the presentation that with the acquisition of Uniper's stake in PecÃ©m II, the company has to assess its statement to include this purchase. It did not have an impact on the cash. But we had a net income of BRL 127 million.

The earnings totaled BRL 54 million for this first half, mainly allocated to the overhaul of ParnaÃba I.

Then finally, we closed the quarter with a consolidated cash of BRL 882 million with stable leverage and a net debt adjusted EBITDA of 2.9x.

With the brief briefing for that, I turn over to Flavia Heller who will introduce some details of our consolidated performance.

Flavia Heller {BIO 20420964 <GO>}

Good morning, everyone.

So we're now going to move on to Slide #5. I will make a brief analysis of the operating performance. All of the plants has better performance than in the previous quarter. And with that, our average results improved to (2%). And 2Q generated 62 gigawatts. And with that, the coal net generation was 19% below what we generated last year. The ParnaÃba Complex had a higher generation in all of the plants in June -- were -- on June and continued so. For the quarter, the gas plant generated a growth of 31% when compared to the same quarter last year. The company continued investing in maintenance and in improving the efficiency of the plant. In the ParnaÃba Complex, the overhaul was concluded for the 2 turbines and also for the steam turbine of ParnaÃba II. Then we also concluded the periodical maintenance as well as different initiatives for operating improvement. And within the revamp in the coal area, we concluded the maintenance of different areas in the system. It's important to highlight that (NIL) determined that we should have a program availability for PecÃ©m II, which went from 95.0% to 92.4%. And in the case of this change, from 95.5% to 94.6%. This review goes back to December 2015. And it generated some penalties, which had been previously taken into account.

And now moving on to Slide #6. The company maintained its track record in terms efficiency in CapEx. The maintenance plan was concluded for the ParnaÃba complex with a savings.

Then moving on to the next slide. In the coal generation, the company also carried out the revamp plans, with costs that were accretive to (what was planned) it is important to say that the initiatives had concrete results. In the case of PecÃ©m II, the time for ship unloading went down with a 62% decrease. And in terms of coal consumption, we also had a 5% decrease.

Now moving on to Slide #8. In the gas production was 0.2 Bcm. And with that, the remaining results at the end of the quarter were of 18.4 Bcm and were stable when compared to 2017 with a replacement rate of 166%.

And now moving on to Slide #9. The exploration program moved on. And we concluded the 2 exploration wells in round 9. The company chose to return the areas of AzulÃ£o and (Pamaiba) and exploration. And so we asked them to extend the conclusion date for some of them.

And so now moving on to the next slide and concluding the financial perform analysis. We had an 18% increase in the first half reaching 118 million. And I'd like to remind you that we have a returning effect and the advance in the amounts of BRL 17 million. And for PecÃ©m II, we had BRL 40 million. The adjusted EBITDA increased 20%, reaching BRL 307 million, which are -- was boosted by the operational improvements in the coal generation and that larger amount of gas produced. Reminding you that as from this quarter, the earnings that we see, too, will be consolidated in the -- in these results.

With regards of net revenue, there was a BRL 20 million reported profit in the Second Quarter of 2018 not only because of the operational improvements. But also by reducing the leverage of the company and the drop which were in the main -- in the excess of the debt of the company. The financial performance in relation to net financial expenses, there was a reduction of BRL (42.2) million. And that had a direct impact in the profit of the company.

Next slide. If we analyze the EBITDA by business segment on Slide 11, we can see that the ParnaÃba Complex had a BRL 26 million positive performance, BRL 11 million in gas generation, mainly because of the fresh results of ParnaÃba IV. And the EBITDA was neutral in the quarter with BRL 8 million in the Third Quarter of 2017. And especially in ParnaÃba III, which had a variable margin, which was higher. So that contributed BRL 15 million in the increase of our EBITDA. We expect to offset the expenses with exploration, which was BRL 26 million.

The trading company had a positive EBITDA of BRL 6 million, a good result of trading operations. And the holding, the contribution was negative in BRL 3 million because of the renewal of some of the software licenses, which occurred during this time.

Next slide. We invested BRL 50 million in the Second Quarter of '18, a reduction of 18% in relation to the Second Quarter of '17. And (inaudible) BRL 42 million were allocated to the generation segment, mainly the overhaul of ParnaÃba and the efficiency program in Itaqui. In the upstream, we concluded the developments of well in GaviÃ£o Azul. And we had a planned maintenance of the gas treatment unit and GaviÃ£o Branco Production Plant.

Slide 13. In this, it has a cash flow reduction of this cash flow of: one, because of the main working capital because of the increase of dispatch in June. A consolidated position of cash was at BRL 882 million at the end of the period, with a balance of BRL 342 million, an increase of 13% in the comparison with June 2017. The investment cash flow was negatively impacted because of payments of the acquisition of AzulÃ£o of BRL 192 million and PecÃ©m II in the amount of BRL 50 million, both done in April 2018.

Now the cash flow of financing operation include BRL 50 million for the PecÃ©m again because of the nonconvertible of the PecÃ©m which was also done in April.

Next slide. Here, we have a -- the debt of the company. This is the index such as CDI. So the drop of the rates has a direct impact on the financial results of the company. And in this quarter, the debt was 9.5% in relation to 11.7%, which we had in the Second Quarter '17. At the end of the quarter, the consolidated debt was BRL 4.4 billion and a debt-to-EBITDA ratio of 2.9.

Next slide. When we compare the debt maturity schedule at the end of June and at the end of December 2017, here, we have the prepayment of the debt of Itaqui in BRL 307 million; PecÃ©m II in BRL 220 million and PGN of BRL 215 million. All these were paid in the First Quarter of 2018. And also the (inaudible), which comes from ParnaÃba III and BRL 215 million in the -- of PGN. With this, the maturity for 2018 and 2019 were reduced to 29%. With the -- between -- by 2019, the company is doing studies in extending the debt with that. And BRL 400 million of this debt would be included in the studies to extend the debt.

I think it's important to discuss this a bit more to understand the impact of (this thing) in the results of ENEVA's. In adjustments for fair value assets at the end of March in 2018, we included BRL 220 million. For these assets, we added some adjustments, were identified by the audit in the fair value of the liabilities, reaching a fair value of identifiable net assets of BRL 777 million.

In the counterparty transferred, we added BRL 50 million to amount paid, 50% with -- of the payment label, BRL 110 million. For this amount, we added the fair value held previously, which was estimated by the company based on the valuation. Just to emphasize this that this value will be reviewed by an independent audit company. According to the current accounting rules, they have -- the company has 12 months to not include the impact of the business combination.

So we had a fair value of BRL 155 million. If we can present the revaluation of previously held interest -- once again, we used the fair value, which was held previously, estimated by the company and the book value of this interest, which is basically 50% of the net value of this date. This day is 30 October 2018, added to 50% of the offer. And with this, we had an acquisitions gain after revaluation of previously held interest of BRL 37 million. Adding these 2, we have an impact in the company's result of other revenue and expenses of BRL 192 million.

Book value, I have to account with deferred taxes related to this, which are basically 34% of BRL 192 million. And bear in mind that according to the current tax legislation, the impact to earnings has a cash impact when the investment is sold.

I'd like to now give the floor to Mr. Zinner for some additional comments.

Pedro Zinner {BIO 17260844 <GO>}

Well before going -- opening to the Q&A session, I'd like to emphasize a few points. But as the letter to our shareholders in March of this year, apart from the performance of the company, we mentioned some objectives for 2018. I'd like to comment on those now.

With regard to the exploration production plan in the ParnaÃba basin, we are going the right direction considering all the reserves which was due in 2018. As you were able to see in the presentation, we finalized the physical campaign with 3,000 kilometers of seismic exploration, those blocks acquired in the 13th round. And we plan to drill wells in 2018.

With regard to the integrity of our assets, we have presented relevant results in the reduction of variable costs in the Itaqui plant. And we achieved the effect of reducing logistics costs at PecÃ©m II, thus, optimizing the offloading the coal there.

With regard to capital structure, we finalized the debt of the IPO debt in relation to Itaqui and PecÃ©m II. And we are working in our ownership structure, getting cash from our subsidiaries and using the present value of the use of these 3 physical options.

And finally, with regards to the acquisition of new energy contracts, we have finalized the acquisition in the AzulÃ£o field of Petrobras. And we registered 2 projects for the next bid in -- which will be held at the end of August. AzulÃ£o, which is a similar of the R2W of the ParnaÃba Complex and also finalizing the cycle of ParnaÃba II.

So we now open to a Q&A session.

Questions And Answers

Operator

We will now start the Q&A session for investors and analysts. (Operator Instructions) Thiago Silva from Santander would like to ask a question.

Q - Thiago Silva {BIO 19419043 <GO>}

I want to talk a little bit about the growth strategy for the company. I would like to know how the company will see this growth from now on. You talked a lot about the closing cycle of ParnaÃba. But also you talked about possible purchases on renewable assets. So I would like you to talk a little bit about that, (inaudible) (offshoot). And also regarding the second question, I'd like to know if you expect to achieve such high levels to the end of the year of (discussion).

A - Unidentified Speaker

Regarding the growth strategy of the company, I think that we have -- we're planning to grow in a sustainable way regarding our capital structure. You mentioned 2 projects. And I highlighted it in my presentation to talk about the growth. I think that these are the 2 main projects for potential organic growth of the company today. And with that, we can consolidate our model. In AzulÃ£o, we consolidated our new (basing). And then the closing of the cycle, which was an extremely efficient project with good returns for the company. These 2 projects will add to -- will add about 500 mega in terms of additional capacity to the company's portfolio. And I think that this is the purpose of the company today. Now regarding inorganic movement, I think that it is kind of our role to evaluate any proposals in the market. We do not have any formal strategy for inorganic growth in the company. I'd like to remind you (John) that the holding has a significant balance of tax losses. And so inorganic growth is evaluated as opportunities to use this fiscal -- this tax loss. And we're going to talk a little bit about Q2. Now regarding the dispatch, I think that we've been talking about this continuously. So in the First Quarter, we had low dispatching. The gas consumption for the first half was below 04 Bcms. Then we had a reduction with scenario for the second half when we have the dry season and that has an impact on dispatching. Then in the north with the power plants with the smaller reservoirs, we'll generate larger capacity with higher dispatching. And so we do expect to have higher dispatching by the end of Q4. And with some reductions in the last week of December. Then our expectation is to repeat the cycle of the previous years, with low dispatching in the beginning of the year. And then with a high period of dispatching after June.

Operator

(Operator Instructions) Mr. Bruno from Goldman Sachs would like to ask a question.

Q - Bruno Pascon {BIO 16451201 <GO>}

I have two questions. One is about the current conditions of the company and the other one is around the cycle.

So the current conditions is a question regarding the company and its proposal for dispatching throughout the year and improvements and plants availability have been very successful. And that's very comfortable for us when we analyze earnings with very foreseeable results. And the cash generation for the first half, it was in the order of 6%. And with higher dispatching for the second half, we expect to have something in the order of 15% to 20%.

So I wanted to understand how the company sees the market and what the market will understand is a trigger from now on, meaning that what the company is planning to deliver. So the concern to how the gas balance and the dispatching nature. The market has behaved exactly as anticipated by the company. And so what do we need to have the recurring cash generation and so that we can close it for the upcoming months? Now the question regarding the cycle closure and the nature of the bid, our secretary commented that the demand is going to be in the order of one gigas. And because we first auctioned the power plants. And then we moved on to the thermal plants, I'd like to understand how these dynamics work because of the demand expectation. So how does the company see the possibility of competition in closing the cycle and the bids? And we have enough in our model with prices close to BRL 66 million to have 11% of assets leverage without taking into account a new financing rate or -- and (it seems we have novelties) in the areas of financing, which has led to considerable cost reduction in the order of 200 or 250 gigs. And so we're probably going to have this going on. But I wanted to understand the competitiveness for the cycle closure in the bids taking into account the importance in terms of supply that this will have for Brazil and for the group as a whole.

A - Pedro Zinner {BIO 17260844 <GO>}

Bruno, this is Pedro. I will try to answer your first question then Lino will talk a little bit about the cycle closure. And maybe I can add something afterwards. So you made a good statement about how the company sees itself in terms of delivering results and adding value. Everything that we have promised, we have delivered. And actually, we have delivered a little bit more. But we have a consistent message in terms of value projection by the market. I think it is difficult for the company to make any judgment. It is very difficult to make a statement about what the fair value is exactly going to be. But one aspect that has been raised in terms of the investment has to do with liquidity. I think that our liquidity has increased. It used to be about BRL 200,000 per day. And it's now between 3 -- BRL 13.5 million per day. I think that liquidity will play a role for a better perception of the fair price of our share. So Lino will say a little bit about the bid.

A - Lino Lopes Cancado {BIO 20167891 <GO>}

Bruno, this is Lino. Regarding the bid and the competitiveness at the cycle closure as you asked and commented. Because it's very competitive, I would like to highlight another characteristic of this bid because there won't be any overcontracting. And it will have a possibility greater than the demand. We will have to accept that we will not be able to have all of the revenues. And it will enable ENEVA to have more projects. So we're going to have a charges of about the 380 in mega and another one of about 100. And we may be favored by the specific characteristic which was included in the bid. Now regarding the demand, our expectation is very similar to what you mentioned of about 1 gigawatt. But we do not know how much is going to be allocated for each different source. Depending on how much is allocated, my previous statement will be reinforced. So when we have a lower capacity there, we may have more competition in the bid.

Operator

(Operator Instructions) We received a question from the webcast and I'm going to read the question. I'd like to understand the arguments used to try to extend the deadlines. Do we have anything new about the (stratified) reserves with regard to the Fourth Quarter of 2018? And also the term is a need for 2018?

A - Unidentified Speaker

The argument to extend the activities are proportionate to what we are promising. We are committing to have additional activities than those that were committed initially. This was the ANP and we're doing this because we believe in these areas. As was mentioned by Pedro, we have returned 2 areas there. And we are intensifying our activities in the other areas where we have extended our term there so that we can carry out these additional activities that we are committing to. With regards to the PADS that end this year and the use on reserves, we have said this to the market. We have sent a report of annual reserves. And they are analyzed in December each year. So we will have a report on the reserves at the end of the year and not necessarily talking about the PADs that -- and at the end of the year, if we finalize the activities that we believe are necessary to analyze the volumes of these PADs, yes, we will include them in the certificates of reserves of the year. If we are unable to finalize these activities and they extend to next year, we will have to leave any information of the used PADs for the next year. But always, whenever we -- the clear trading of a PAD, which does not mean let's talk about the reserve, (intensify) the reserve, we have to inform the market. And it becomes public information immediately. If we decide to end a pad before the due date with a declaration of trading, this will be automatically public information.

Operator

(Operator Instructions) If there are no further questions, I'd like to refer for the company to make their final comments.

A - Pedro Zinner {BIO 17260844 <GO>}

I would like to thank you all for joining in our earnings webcast and hope to see you the next quarter. Thank you very much.

Operator

Thank you. The ENEVA teleconference has ended. Have a good day.