Q2 2014 Earnings Call

Company Participants

- Fabio Bicudo, Chief Executive Officer and Investor Relations Officer
- Frank Possmeier, Executive Vice President
- Ricardo Levy, Chief Financial Officer

Presentation

Operator

Good morning. Welcome to ENEVA conference call to discuss the second quarter results and other matters. At this moment, all participants will be in listen-only mode. Later on, we're going to start a question-and-answer session, when further instructions will be given. (Operator Instructions) I'd like to remind you that this conference call is being recorded.

Now, I would like to give the floor to Mr. Fabio Bicudo, the CEO of ENEVA. Mr. Bicudo, you may proceed.

Fabio Bicudo {BIO 15000971 <GO>}

Good morning everyone, thanks for being on the call for our second quarter results. I wanted to walk you quickly through the pages that we have here, the first two pages, then Frank Possmeier and Ricardo Levy will walk you through some of the other slides and in the end, I'll make a closing comment.

Today, I am a bit pressed for time and I may not stay through the end, because I will be going to Brazil to continue our dialog with a regulator. But very quickly, I think this is an important quarter for ENEVA. We see here, as we keep saying, the company transitioning from pre-operational status to an operational one, all of the main numbers here, figures are positive in terms of revenue growth, operating costs relatively under control, operating expenses down, positive EBITDA. I think that's an important highlight.

Net income still showing a loss, but improving nonetheless and a reduction in net debt, that actually has a little bit to do with deconsolidation of Pecem II. I'll alert you and Levy and Frank will both talk about the effect of the deconsolidation of Pecem II and the numbers, but throughout the presentation, you'll have an impact of that in the numbers.

I think overall, as I mentioned, we have increased commercial capacity, and higher sales. And again, an improving performance in the plant little overhead have resulted in higher EBITDA. Important landmark in the capitalization process and asset disposal of ENEVA, so the first phase capital increase was included as you all know, BRL174 million raised. And also the sale of Pecem II -- 50% of Pecem II to E.ON, which allow the company to raise an additional BRL408 million approximately.

Last on Parnaiba II, I'll talk about it on the next slide. We continue discussions with Aneel, I think they're quite advantage, as I said, I'll be there again today. But going to page three, walk you through a little bit of where we are with the regulator on that Parnaiba II plant. Parnaiba II, the proposal that ENEVA made basically revolves around finalizing the plant before year-end this year. Second, delaying the PPA start date to July 2016. Of course, if we're able to start it earlier than that, then that can happen and we'd receive revenues earlier than planned. A penalty that would be approximately BRL310 million. The penalty would be paid for -- by the client itself over the life of the PPA, so that's over 18 year lifecycle and that would be done through a reduction in fixed revenues. In the end, we would continue the bid bonds would remain in place until July 2016. It is already there. So there should renewing or extending the bid bonds until July 2016.

What are the main, let's say, advantages? The first, the proposal puts a barrier or puts a landmark number around Parnaiba II. I think there has been a lot of uncertainty in the market as to what that could represent. So this helps really put a handle around the number around the Parnaiba II exposure and gives flexibility for both ENEVA and PGN to work respectively on their infrastructure, on our and their infrastructure issue.

The second, this delay of the plant until 2016 also provides flexibility for ENEVA and PGN in managing the resources of the entire Parnaiba Complex. The chart in the second bullet here just describes a bit of things that we can do. One of them is using the Parnaiba II plant to actually substitute other less gas efficient machine that actually creates an important buffer for all of us given the high dispatch scenario.

So that between now and then, we can also use the Parnaiba II plant to optimize as keep saying the gas production and make sure that we are managing those fields carefully in this 100% dispatch scenario. So we see a solution for Parnaiba II. We also see improved flexibility for the entire Parnaiba Complex. We would be able to generate our PPA commitment amounts with a much lower amount of gas. So again, that gives us extra flexibility in this period of high dispatch.

Last, it also provides what we see as an option to resume growth. So by committing to close the cycle subject to an auction in the regulated market that of course has minimum return hurdles that we would require and also having availability of financing for the project, we see closing of the cycle as an attractive investment opportunities as with this negotiation with Aneel and Parnaiba II. We also again open or create this optionality.

The negotiations are ongoing. We've spent a lot of time in the last few weeks with Aneel. We've been disclosing to market developments as they happen. We cannot, at this point in time, give a specific date on when we think this will be resolved, let's say, we're quite close. The main topics that are being discussed are really details around different elements that I described here. I'd say, at this point, there's no material deviation from what we've disclosed to the market and we'll keep everyone informed. Again, today I'll be there with our team, and as we have more to disclose, we will. We think overall this is a, as we kept saying before, a balanced solution for ENEVA and for the regulator that allows the preservation of a contract that has attractive prices for consumers is an important step forward also for ENEVA and PGN in terms of developing the Parnaiba Complex.

With that, we'll continue with the presentation, going into more detail on EBITDA, on costs and expenses and then an overview of the plant.

Ricardo Levy {BIO 16259732 <GO>}

Good morning. Ricardo Levy speaking. On slide number four, let's talk about the EBITDA development. We see that ENEVA came from a negative figure in the second quarter last year of 38.6 million negative to a positive figure for second quarter 2014, where we stated a BRL79.3 million. Despite the fact that Pecem II contributed only with two-thirds of the quarter based on the conclusion of the partial sale of Pecem II to E.ON as already mentioned by Fabio. We could've [ph] attached first that the operational improvement performance of Itaqui and also a much better stable performance for Parnaiba (inaudible). All operational performance, of course, we will see more details in the following slides.

Another important element that contributed for the better performance of the second Q EBITDA was certainly less expensive. Also on the operational level, but especially on the HoldCo level. As you are aware, as part of our whole plan, we have already implemented a cost control and our cost reduction plan, that starts to bring us good results during the second quarter of the year. When we look to the EBITDA in a consolidated basis, the performance year-to-date, we came from a negative result of BRL176.2 million in the first half of 2013 to BRL183.2 million positive in the first half of 2014 based on the main drivers I just mentioned here and showing that we are in the right way to improve results.

Moving on to slide number five, talking about costs and expenses. Starting with the operational costs, partially, of course, positive impacted by the reduction of the fuel costs of Pecem II, once again resulting from this deconsolidation, less revenues, less costs and less EBITDA, that we mentioned here, only because we was not consolidating in June this asset.

Again, we see also a reduction in Parnaiba I lease cost based on the gas supply agreement, which also contributed in a positive way. We could see that these effects brought a 12% reduction on the operational costs when we compare the second Q 2014 with the first Q 2014, when we came from BRL446 million as operating costs to BRL393 million approximately this quarter. Reduction on operating costs is also in line with lower gross energy generated that's also is -- we attached here that we drop 13%.

On the holding level, the reduction on expenses were even more representative, as I mentioned. We already mentioned to market and we already launched the cost reduction plan where we start to see the results. When we compare the second Q '14 with the first Q '14, we see approximately BRL8.4 million reduction. However, in a different way representing 30% reduction coming from BRL28.8 million to BRL20.4 million as [ph] representative, mainly due to headcount reduction. We are focused on, let's say, streamline the structure of the company, but not only in, let's say, low salaries headcount, but also in senior managers and senior positions. Important decisions were already taken and impacting positively the results.

Other measures in personnel, we still -- we'll make also other important things like restructure, few relevant contracts we have like IT, reducing three floors of our headquarters here that will allow us to save close to BRL4 million a year and several other small measures that jointly will bring an effort to a more sustainable cost base during the third quarter of this year.

Headcount at holding level was 153 people in the end of June. We can anticipate that we are at 147 level in July and we continue focus on doing all efforts needed in order to bring again (inaudible) here, but to a more sustainable basis for the ENEVA.

Frank Possmeier {BIO 18083214 <GO>}

Okay. This is Frank Possmeier, I would like to take over to run you through the operational performance of our power plants. Although it is true that compared to last year's figures, we have significantly improved our operational performance. When we look at how we developed over the first six months of this year, you will see some light and shadow with respect to our power plants and the performance of our plants.

I would like to start with our fully consolidated businesses, Itaqui and Parnaiba I, and then concentrate on our equity participation in Pecem I, Pecem II and Parnaiba III. As Levy already mentioned, since end of May, we consolidated -- we have deconsolidated Pecem II and hold it as asset held for sale and then conclude it by the end of July for 50% sale to E.ON for approximately 400 million.

Let me start, as mentioned with our fully consolidated businesses Itaqui. Here we see a decline of EBITDA by approximately 40% from BRL36 million in the first quarter down to approximately BRL20 million, which is due to a lower dispatch in the power plants and in addition to that higher operating costs that we have on a comparable basis.

When we look at these two effects, a lower dispatch, that's mainly due to an outage that we had in May and June, where we replaced the boiler fan bearing, so the same equipment and where we also did repairs and maintenance on the emission control system, which reduced the availability of the power plants in the second quarter to 62%. But when you then look at the performance afterwards, I think for July, Itaqui really realized the best performance ever with an availability of north of 90%, I think reaching 92% in the course of July.

When we look at the cost base, the main reasons for the higher cost base is that we have higher coal costs due to two effects. On the one hand, it's a Colombian coal effect, so due to the close down of the Drummond Harbor and the Drummond facility, we have to buy higher coal, as more expenses coal in the international market that has a negative effect. And in addition to that, we had an infrastructure issue where we still have the problem in Itaqui that we only can import with smaller vessels through the harbor, and therefore, have higher operational in coal cost.

When we continue and looking at the performance of Parnaiba I, we see a much better picture. We still have a very good performance and availability is north of 98%, 99% of the power plant, translating into a better performance on the EBITDA level from 44.8% to 50.3%. We have on the one hand there a reduction in the net operating revenues, which was mainly due to lower gas prices and lower Henry Hub prices, which was then overcompensated by the positive effect of lower operating cost and then ultimately translating into a better EBITDA performance of Parnaiba I in the second quarter compared to the first quarter.

This brings me from our fully consolidated businesses to our equity participation. I'll start with Pecem I. Here when we look quarter-over-quarter, we have a better performance of Pecem I from 71% in the first quarter to 77% in the second quarter. What you see here is an 83% availability, that is an ONS availability that we show here, which is due to the fact that we got a credit from ONS for the outage that took place in December and main part of January, as a (inaudible) of that power plant, so the ONS recognized availability is 83 whereas the re-availability of the power plant in the first quarter has been 71. So we were able to improve that even then in the second quarter.

When we then look at the EBITDA development from BRL48 million down to BRL32 million, that is on the one hand, we have due to higher production approximately 150 gigawatts hour more production, higher net operating revenue of BRL9.6 million, but that was eaten up by higher absolute operating costs, mainly due to the so-called (inaudible) the inflated cost where we have to buy due to the non-performance of the power plant last year, energy in the market via free market collateral.

Moving on to Pecem II, I think still our best power plants with our performance, from average performance this year of north of 96%. So we are outperforming our contractual obligations under the PPA in the whole of 2014 by now. Nevertheless, we have a reduction of EBITDA from the first quarter of BRL46.3 million down to BRL33.5 million. That is -- main effect is due to lower prices in the second quarter on the CIB [ph] side where we reduced our net operating revenues and had higher cost in the second quarter due to third-party services that were necessary in the power plant.

Last, but not least, the performance of Parnaiba III, when you look at the availability of the power plant, it has significant reduction in the second quarter, that's due to several effects in May, we had a shutdown of the power plants due to lower PLD [ph] prices, with an economic to run the power plants and then unavailability in June due to inspection on the turbine and maintenance and also gas optimization. But overall translated into reduction of EBITDA from the first quarter of BRL14.4 million down to negative BRL8.4 million in the second quarter.

Ricardo Levy {BIO 16259732 <GO>}

Moving to slide number 11, let's cover the consolidated cash position. We see that a combination of a -- operational results and the initial step of the stabilization, capitalization plan being implemented, brought a stable cash flow for the company during that quarter. So we started with BRL84 million, as I mentioned, good results on operational brought a positive net revenue, especially good performance of Itaqui, and the Parnaiba I. The CapEx that we spent around BRL95 million, mainly due to Parnaiba Complex, especially the Parnaiba II. As you are aware, we are almost concluding this important plant. So we will still face a few investments related to that.

Then the capital increase contributed, as you know, as part of the plan, we already concluded the first phase of that capital increase. It means that we had funds coming from especially from E.ON and as few minorities. That we have the opportunity throughout these plants to BRL100 million short-term debt lent by the commercial banks that will be paid once we have a long-term finance from Pecem II. There is discussions and expected to be a launched during the following weeks.

Of course, we still have debt service, we have interest to serve. And others means, a few cash collateral related to loans, especially with PNGS [ph] which brings us to a balance capital cash position during this quarter. Certainly, you can see different figures during July especially to date, mainly due to the conclusion of the Pecem II sale to E.ON.

On slide number 12, the consolidated debt. In the last part of the slide, we see that we show here a drop comparing to the end of last year of approximately 1.1 billion, mainly due to the deconsolidation of Pecem II. So this is not a prepayment of debt. What is important here to emphasize is, once we see the short and long-term ratio here, on the short-term, we -- that we present here approximately BRL3.1 billion, still [ph] in a short-term, BRL1 billion only represents on a project level being BRL0.2 billion related to Itaqui and Parnaiba I, that will be extended during the following months.

The bridge to Parnaiba I already renegotiated for 2015. And almost BRL800 million loans to Parnaiba II that, of course, based on the current environment of the Parnaiba II project. These maturities for December '14 and June '15 will definitely need to be rescheduled.

On the HoldCo debt that represents 2.1 billion. As I think all of you are aware, we agreed with the banks on May 12, a few conditions for this debt. So first, we intend to push down part of this debt to project levels until year-end. We also have an agreement of extending the remaining debt that will stay at the Holding Co after this pushed down to five years with three years of grace period.

And what has been agreed already part the plan for the following two, three weeks is the long-term financing for Pecem II, as I mentioned, in order to pay partially the -- to use the proceeds partially to pay the short-term debt, that I mentioned, BRL100 million from the commercial banks, and also BRL150 million more from PNGS under discussion. So as you know, we have implemented several steps from the plan until now, but we still have room to additional steps that should be implemented from now on until year-end. Everything until now is on schedule.

Fabio Bicudo {BIO 15000971 <GO>}

So to conclude page 13, main takeaways from this quarter. First, as I said in the beginning, we continue the transition from pre-operational to operational. You can see that in different aspects of the company. I think there is a clear plan for operational improvement that is being implemented and bring improvements in our operations. There is a lot to be done there. Operating or fleet in an environment of 100% dispatch as Brazil is facing now is a challenge. We've made it clear on all of our calls. So the team that is leading our operational efforts has that additional task of keeping everything working in a high dispatch scenario.

Moving to financial restructuring, I think Ricardo Levy mentioned, that we've concluded important phases, including the sale of 50% of Pecem II to E.ON which has brought in additional cash to ENEVA for the second quarter closing. And the HoldCo restructuring is underway. And you can already see some of the cost reductions that we had signaled to the market in prior communication. We will, of course, continue the plan with a second capital increase later this year in the third quarter. And once we have more details, we'll come out to the market with those.

Parnaiba II as I said, there is a proposal out there, we're getting close, we've been disclosing to the market where we are. We are putting really a cap around that penalty amount. It also allows us flexibility in managing gas in this high dispatch scenario for the rest of the Parnaiba Complex and it allows us with the appropriate conditions to resume growth. I have to say that we've also disclosed that to the market that the burden of the Parnaiba II plant is something that we share with PGN with our gas supplier. We are also in discussions with PGN on sharing this penalty and other amounts related to that Complex. But those are positive discussions constructed where we both see the merits and the benefits of delaying the start up of that plant.

Last, we're also analyzing the impact of this high dispatch scenario not only on our gas and the need for optimizing their infrastructure, but also on our core contracts. I think one of the surprising elements we see here is that ENEVA has been continuously dispatched most of its plants for quite some time. That is unusual, that was unplanned for, and in a way it's part of what's happening in Brazil and the system and the hydrology. But it's something that we have to pay attention to and discuss and have a dialog with a regulator around, so that we can have equitable treatment of the investments that have been made and the efforts that the company is making to provide electricity in a time of need before or to the benefit of our shareholders and investors.

This was an encouraging quarter. I think there are many, many challenges, we are definitely far from concluded what is the plan that we started out on some time ago. So we will keep you informed and thanks once again for being on the call.

Questions And Answers

Operator

Ladies and gentlemen, we are starting now the Q&A session. (Operator Instructions) This concludes our Q&A session. I'd like to call Mr. Fabio Bicudo for his closing remarks. You may proceed sir.

A - Fabio Bicudo {BIO 15000971 <GO>}

Thanks everyone for being on the call. We'll keep you informed, as I said, we have important aspects to tackle in the coming days and weeks. Thank you once again for being on the call.

Operator

This concludes ENEVA conference call for today. Thank you all for joining us and have a great day.