Q3 2013 Earnings Call

Company Participants

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

Presentation

Operator

Good morning, ladies and gentlemen, at this time, we would like to welcome everyone to SABESP's conference call to discuss it's results for the third quarter of 2013. The audio for this conference is being broadcast simultaneously through the Internet at the website www.sabesp.com.br. At that same address you can also find a slide show presentation available for download.

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

Today with us we have Rui Affonso, Chief Financial Officer and Investment Relations Officer Mr. Mario Arruda Sampaio, Head of Capital Market Investor Relations and Mr. Marcelo Miyagui, Head of Accounting. Now I'll turn the conference over to Mr. Arruda Sampaio. Sir you may begin your conference.

Mario Arruda Sampaio

Great. Thank you. Well, good morning everybody. Thanks for joining us for -- one more earnings conference call. We have established to slide presentation and discuss the main events during the period. And as usual we will later open for a question-and-answer session.

Let's move then to slide first slide, slide three gross volume. This increase in gross volume in the third quarter this year was due to the increase of 2.7% in water connections and 3.4% in sewage connection and to the increase of 1.9 in billed of water volume and 2.1% in billed sewage volume all that leading to a total increase of 2% in billed water and sewage volume in this quarter when compared to the same quarter last year.

The lower billed water and sewage volume increases is due in great part to higher rain fall and lower temperatures in the period and these variables both having direct and big impact on water consumption and consequently on sewage volumes.

This for you to have an idea. The average temperature was 18.5 Celsius in July last year, I guess 17% July this year, so for us cold period. The water loss ratio continues to decrease closing the quarter at 25%. It is also important here to mention that of the funds that you contracted with strike[ph] at the beginning of last year totaling about BRL 1.5 billion, around 1 billion corresponds to the execution of services and the management of water loss program, which are in the final phases of contracting.

The other 500 million are related to the work itself and should be undertaken and accomplished by 2015 with this schedule in relevance share of the water loss reduction initiatives will begin in the fourth quarter of this year right now as we go through the fourth quarter and we expect the ratio to fall as of the beginning of 2014, but it's really important to bear in mind that the ratio will drop immediately because it's a moving average of the last 12 months. Okay.

Now moving to the slide four, let's comment briefly on our financial results. Net operating revenue grew 2.3%, most probably positively affected by the 5.15% tariff increase as of September 2013, also the tariff repositioning index of 2.35 applied in April this year, of the 2% increase in total billed volumes, which we just mentioned and lower construction revenues in the period.

Gross operating revenue, the one that disregards construction revenue in COFINS and PASEP taxes, on the other hand grew 5.8%. The lower than expected drop in net operating revenue increase was mainly due to the conclusion of the implementation of the TACE services in the municipalities that we provide services in the interior of the State of Sao Paulo follow in the second quarter of 2012.

This led to a reduction in the number of unbilled water supplier and generated lower revenue estimate in June 2012. This estimate reduction cost it lower reversal in July 2012, what led to a substantial impact on the variations presented in the analyzed period. So the impact due to the, how we measure and how we project revenues and then how we refers that in the next quarter.

Excluding these non-recurring events, net operating revenue would have grown around 4.6%, while gross operating revenue would have increased by 10%. Costs, sales, administrative and construction expenses fell by 2.4% in the period. However, if we exclude construction costs, which fell by almost 60%, cost and expenses edged up by a mere 0.8%.

When we analyze cost and expenses as a percentage of net operating revenue, we notice that a reduction from 73.4% in third quarter last year to 70% in this quarter.

Adjusted EBITDA increased by 15.5% from 902 million to 1.042 billion in this quarter. The EBITDA margin came to 37.6% versus 33.3% the same period in the previous year. If we exclude construction revenue cost, the adjusted EBITDA margin reached 46.4% this quarter versus 42.4% third quarter 2012.

Net income, as you can see totaled 475 million, 31.3% above third quarter 2012.

On slide five. Let's discuss the main variations in cost in relation to the same period of previous year. Cost and expenses increased 0.8% as mentioned due to the upturn of 62.7% in treatment supply, 14.6% in payroll and benefits and in great part -- sorry, and 15.6% in depreciation and amortization, plus and also 9% in services. So these are the ones we are going to highlight.

On the other hand, we also like to highlight, decline of 60.8% in credit write-off, 31% -- 36.1% in general expenses and 8.1% in electric power. Now specifically on treatment supply, increase of 62.7% or 24.5 million. This was mainly due to the higher consumption of chemicals associated with a lower quality of rough water and price adjustment, some of which of these prices were associated to the exchange rate variations against the reis.

Payroll and benefits move up chiefly due to the 8% increase in wages. Since May 2013 this also associated with the company's new plan for job and salary, with an impact of approximately BRL27.8 million and BRL9.7 million increase in the provision for the defined benefit plan, in this case due to changes in actuarial assumptions, mainly related to the discount and interest rate.

Depreciation and amortization climbed 28.2 million or 15.6% due to the transfer of work in progress to operating intangible assets been into a net impact of BRL2.1 billion.

Services increased 23.5 million or 9%, due to the 12.5 million increase arising from the reversal of provisions for expenses in third quarter 2012 related to the conclusion of the first partnership, the agreement we had with the municipality of Sao Paulo.

And also due to BRL6.6 million increase in expenses with sewage network maintenance, due to the intensification of presenters maintenance in several regions operated by the company.

Credit write-off fell by 42 million or 16.8% this quarter, essentially due to the need for additional provisions totaling 41.2 million undertaking in third quarter last year. General expenses fell BRL75.7 million for the most part due to additional provision for risk related to labor losses, totaling 27.9 million in third quarter last year 2012 together with the reversal of provisions for risks related to environmental losses totaling about 20 million and provisions for civil losses totaling about 50[ph] million in this quarter.

Electric Power decreased 11.7 million or 8.1%, mainly associated to the average reduction of approximately 22.7% in the distribution system, given the utilization tariff. As a consequence provisional measure 579 of last year, late last year and Law 12,783 of this year.

Let's now review items that affected our net income on slide six. In the third quarter of 2013 net operating revenue increased 61.4 million or 2.3% over the same period in 2012 due to the 2% upturn in total billed volumes associated with the 5.15 tariff increase effective as of September 2012 and the tariff repositioning index of 2.35% or 35% applied since April of this year.

Cost and expenses including construction costs decreased by 48.1 million or 2.4% over the same period in 2012. Net finance expenses and revenues including monetary exchange rate variations had a 10.6 million negative impact on the variation between the period. This was mostly due to four points here, the 63.6 million increase in expenses with the exchange rate variation on loans and financing primarily due to a lower capitalization of this expense in the intangible assets in 2013.

Lower monetary exchange rate variations arising from higher provision for losses in third quarter 2012, leading to a BRL12 million decline, third item would be that 34.1 million reduction in finance expenses predominately due to the decline in interest rate paid due to debt slot more specifically, the 17th the bank's rations in February this year in connection to the early settlement of the outstanding -- of the outstanding balance of the 11th debenture which have higher interest rates.

And at the same time reduced interest rates on the provisions for losses. The 6.9 million increase in financial revenues and monetary variation on assets was another item. This was mainly due to the interest and updates supply on Installment Agreement and also to income earned on financial investment.

Income tax and social contribution expenses increased posted 16 million due to the increase in taxable income in this period.

Let's move on to slide seven, here we would like to comment on the financing for our investment plan. In October this year the Ministry of Cities disclosed the results of the selection process which 18 of SABESP projects benefit from FGTS/FAT through the Caixa Economica Federal, Scotiabank and FAT fund, those are directed through the BNDES Bank, all this totaling close to BRL1 billion. These are probably now the national funding sources for the most appropriate conditions for sanitation project in terms of interest and amortization profile talking 12,14,15 24 years terms here.

These funds are intended to sanitation projects in the Sao Paulo metro region, by Santos (inaudible) also. Of this amount, close to 800 million is for sewage projects and 200 million for water project.

The disclosure of the selection projects is an important part of the process that allows access to funds. Next watch closely the financially, verifying and validating the technical aspect of the project and assessing projects and company risks. Reporting to the scheduled disclosed by the Ministry of Cities, the fall should be finalized hopefully by June 2014.

The main focus of the projects that obtained financing for water, it's expand production and reposition capacity the metro region is such to secure for a longer time, our current levels of services which 100%. In sewage the goal is to reach full collection coverage and treatment largely in the Sao Paulo metro and Santos metro region. This is our target by 2020.

Now with these 18 projects the term of funding already secured by profits of being secured. That were objects to a selection by -- conducted by the Ministry of Cities in 2012 and '13 reached BRL3.4 billion. What is an important that this is ensuring greater liquidity and certainty in the execution of the company's investment plan for the period until in this case 2017.

In other words, we have very little investment financing -- great investment financing reducing required liquidity risk, for the rest of the period. Let's move now to slide eight. Here, we will comment on a very important item for SABESP. The adjustment of the tariff adjustment announced by effect on November 1. As you all know since October 23 the SABESP Board has presented the minimum necessary quorum to deliberate on matters related to SABESP tariff revision and our adjustments which had been informed on whole since August 2013.

On November 1, ARSESP disclosed resolution for resize authorizing 3.1451% [ph] tariff adjustment effective as of December 11, 2013. This adjustment initially considered inflation measured by the EPCA which in August, 2012 and July 2013 of 6.27% or 7%, but ARSESP deducted from this figure to expected for the period, which was 0.4297%[ph] resulting in an increase of 5.8410% [ph].

ARSESP also estimated the revenue gain the company has with a 235 or 9% increase, as of April, 2013 meaning in this case to an additional discount of 0.9249% [ph] in the index. On the other hand, ARSESP also estimated SABESP revenue losses related to the delay with the tariff adjustment to EPCA at 0.6538% [ph] and added the estimated amount to the index. The product of these changes and considerations resulted in an increase of, as mentioned 3.1451% to be applied as of December, 11 and the details you can see in the slide.

Let's now move to slide nine. In this case, we'll talk about ARSESP Resolution 434, which defines SABESP's new tariff revision schedule for the cycle still between August 2012 and August 2016.

2014 was established as the date for the publication of the initial tariff maximum price P0 and efficiency gains factor, the X factor for the tariff cycle. ARSESP also established the future stages for the conclusion of the tariff revision, according to this new schedule, (inaudible) will present the adjusted asset base by December this year. In fact, regarding this stage of the regulatory agencies 1920, SABESP already filed response to 9 and the remaining will be delivered certainly on time.

On January 10, 2014, ARSESP will disclose its proposal for the Initial Tariff Maximum Price and the X factor and at the same time begin a public consultation period and held for a public hearing, which in fact should be occurring on February 5. So, February 5, the public consultation period will be completed and the public hearing will be held. So we will know our accept opinion and over at the asset base and all the methodology by the beginning of January 2012[ph].

On March 10, as we mentioned the final initial tariff maximum price and the expected results will be published as well as substantiated report on the contributions that we're we seeing during the public consultation period.

And at the same time, ARSESP will provide the schedule for the definition and implementation, for the new tariff structure, the tariff structure discussion will not happen until we get the new schedule as of March 10. That concludes our initial remarks and we'd like to open now for questions and answers.

Questions And Answers

Operator

Thank you, ladies and gentlemen, at this time, I would like to remind everyone that in order to ask a question (Operator Instructions). It appears that we have no questions at this time, I would like to turn the conference back to you SABESP's for their final remarks.

A - Mario Arruda Sampaio

Okay, well thank you everybody who are participating and listening to the speech. And, but we're always available in case if you would like to cover some specific questions call. Thank you and see you next quarter. Bye Bye.

Operator

Ladies and gentlemen, the conference has now concluded. We thank you for attending today's presentation. You may now disconnect your lines.