

Q4 2006 Earnings Call

Company Participants

- Antonio Previtali, Investor Relations Manager
- Marc Verstraete, Finance and IR Director

Other Participants

- Marcio Prado, Analyst
- Sergio Tamashiro, Analyst
- Stewart Ragar, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by. (Operator Instructions). As a reminder, this conference is being recorded. I would now like to turn the conference over to Mr. Antonio Previtali, Investor Relations Manager of Tractebel Energia. Please go ahead.

Antonio Previtali

(technical difficulty) under Investor section. Our earnings release can also be found in the Web site.

Before proceeding, let me mention that actual performance could differ materially from that anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

With us today in Florianopolis this morning is Mr. Marc Verstraete, Finance and Investor Relations Director. First, Mr. Verstraete will comment on the Company's Fourth Quarter results. Afterwards, we will be available for a question-and-answer session. It is now my pleasure to turn the call over to him. Marc, you may now begin.

Marc Verstraete {BIO 18446542 <GO>}

Good morning, to everybody. Thanks for joining today's conference call on our 2006 results. I will discuss here briefly the strategy of the Company. Thereafter, we will go through the growth, no actually we will discuss the strategy, the spot market, the growth and to conclude with financial performance.

So if we first start with the strategy on page eight, where you can see on the left-hand side of the slide, the energy market outlook and with the situation in 2007 of supply higher than the demand. This situation would shift as of 2010 if no new projects are built whereby the demand can become bigger than the supply. This shift is reflected in the price curve, the blue curve you see there. This curve is the average of the old and new energy prices sold in the auctions organized by the government, according to the new model. So you can see increasing prices in the future.

On the right-hand side of this graph, you see the -- what is the situation of Tractebel Energia's uncontracted energy. So you can see that in 2007, we are almost fully contracted. In 2009-2010, the Company will have 10% of its energy uncontracted, rising to 30% in 2011-2012. On the following page, page nine, we are showing the energy balance with more details. So we open it -- you have the total resources being composed of resources coming from the plants and purchases. And then you have the sales; you have government auction sales or bilateral sales. The difference between total resources and total sales gives you the balance. Today, we are releasing for the first time the average sales price for 2008 and the average purchase price for 2008 as well.

Well if we move to our next topic, the spot market on page 11, we -- I want to explain very briefly one mechanism here related to our thermal plants. As you know, Tractebel Energia is mainly hydro based -- 20% of its capacity comes from thermal plants, representing roughly 900 average megawatts. Of this 900 average megawatts, 450 is dispatched -- the 450 megawatts of the plants run all the time due to what we call inflexibility. What does it mean? It means that we have to burn a certain amount of coal, which is by the way fully subsidized and in order to allow this, we have to run the plant and they are producing on average roughly 450 average megawatts.

The remaining 450, the dispatch of these plants, will depend on the spot price. If spot price is below the cost to run the plant, the plant will not be dispatched. Since we sold this energy, we are obliged to buy the energy on the spot market. This is what we call the thermal substitution energy. And in the Third Quarter and the Fourth Quarter of last year, spot prices increased. And so, the -- this quantity of energy that we buy on the spot market became more expensive and this was reflected in higher cost.

On the following page, we are showing you okay, what are the drivers of the spot price. You have, of course, the reservoir level, you have the rainfall behavior, the forecast of demand for power. And the current and future availability of power plants and transmission lines. And also last but not least, the availability of natural gas. On the same page, we are showing a graph with the following information. The orange line is the spot price. So you can see that 50% of the times, spot price is below R\$20 per megawatt-hour. 75% of the times spot price is below R\$40 and only 25% of the time spot price is higher than R\$40. And in our case, our exposure is capped at 120 because at this time, the reservoirs [ph] is being dispatched and will produce energy.

And in the third and Fourth Quarter of 2006, spot prices was exactly, let's say between -- between -- in this range. The average spot price for the Third Quarter of 2006 was R\$106 and in the last quarter was R\$77, as you can see on the following page. When we have a look at both in the South -- Southern and the Southeastern market, the spot price and the

reservoirs. So you can see in the third and the Fourth Quarter, high spot prices, low reservoir. And now beginning of 2007 the contrary, low spot prices around R\$20 per megawatt-hour and higher reservoir levels. In the Southeast, the main reservoirs of the country almost 90%.

If we move now to our third topic of the day, growth, we are going to page 15 where we have the first project, which is called Sao Salvador. It's a 240-megawatt power plant. The group started construction earlier last year. Construction is going well. And the idea is that project, which still belongs to our controlling shareholders, will be sold to Tractebel Energia in the first half of 2007, in the Second Quarter of this year. This project is under construction.

Then we have another project, Estreito on page 16. The good news here is that the Estreito at the end of last year received from IBAMA the Installation License. So this will allow the project to participate in the new energy auction, which would take place in May of 2007 and hopefully we'll be able to sell the energy and to start construction. It's a much bigger project of 1,087 megawatts, of which SUEZ owns 40%.

Beside these two hydro projects, Tractebel Energia is also looking at thermal projects, mainly a coal-fired plant in the south of Brazil, where you have a lot of coal and at interesting prices. The project we are starting here is a 240 -- 340 greenfield coal-fired plant, which could enter into operation in 2012 and the energy could be sold to the Brazilian or the Uruguayan electricity market. Besides that, there would a set of bagasse-fired cogeneration plants located in the State of Sao Paulo. These are small, out of the total excess energy, for sale would be 55 megawatts average. And the idea is to participate with these projects in the new energy auction, the new upcoming energy auction. So these are the projects we have in the pipeline in terms of growth. Then, we can move to our last topic of the day, which is the financial performance.

So on page 19, first of all, the net revenues. So 2006 Tractebel Energia posted net revenues of R\$2.7 billion compared to R\$2.2 billion in 2005, with an EBITDA of almost R\$1.6 billion compared to R\$1.450 billion last year. The EBITDA margin though, as you can see on page 20, was a little bit lower than last year -- 59% compared to 63%. The main factor for this lower margin is the fact that Tractebel Energia bought lot of energy to be resold. And this activity, this trading activity, let's say, of course, to explain that lower margins than the activity of producing energy and selling the produced energy.

The net income reached almost R\$980 million and it was a record net income and a nice increase compared to last year where the Company posted R\$920 million net income.

If we move now into the highlights of the Third Quarter -- the Fourth Quarter, first of all, the physical sales increased 19% -- 17%, reached 4,000 average megawatts compared to 3,300 last year. The average price has increased 5%, reached 90 compared to 86 last year. This combination of higher physical sales with higher prices of course led to higher net revenues, 22%. The EBITDA, despite this higher revenues, was below the figure of last year mainly due to the high expenses related to what I explained earlier, the spot market transactions, the substitution energy that the Company had to purchase.

Net income reached R\$188 million, being R\$0.29 per share.

If we go to the following page, page 22, you will see that the main information, the same information but presented, let's say, graphically. So the energy sold as I said, increased both compared to last year as to the previous quarter. The average price of energy also increased compared to last year, decreased a little bit compared to the previous quarter. The EBITDA was lower than last year and was also lower than the Third Quarter of '06.

We should not forget that the -- in the Third Quarter '06, there was almost R\$90 million of non-recurring EBITDA coming from a lawsuit that we won related to PIS and COFINS taxes and we have the same effect if we look at the net profit. The net profit is lower than the previous quarter also due to this non-recurring impact in the previous quarter.

Both -- the main highlight here is really the higher expenses related to the transactions done at the CCEE which is the energy trading -- the spot market. This increased substantially compared to last year. On the following page, we have the overview of the debt. Tractebel Energia closed the year with a net debt of R\$1 billion; total debt of R\$1.2 billion. On the graph, you can see the red line. This is total debt over the EBITDA, which is 0.8. So we have a, let's say, underleveraged the Company.

Moving to the following page, we have a page -- it's on page 24, we have a look at the capital expenditures. The first comment is with respect to the existing power plants, the CapEx for 2007 is expected to be R\$96 million. So it is higher than in the previous years. Then, we have the CapEx related to, here I am only showing, our equity in Sao Salvador and Estreito Projects, which is around R\$420 million for 2007, bringing total CapEx to R\$0.5 billion; R\$516 million.

One reason for having a high CapEx year in 2007 is that part of the Sao Salvador started construction in 2006. So when we refer to the project, we will have to reimburse the current shareholder for all the equity already injected in the project, of course.

On the following page, we have a page about the dividend. The good news is that the Board decided to maintain dividend payments -- dividend payouts over 95%. So we have the dividend per share of R\$1.43 for 2006, which is a 6% increase compared to last year. Then the dividend yield was 8.6%. So very high dividend yield compared to our peers.

With this, I would like to conclude here the presentation and start the Q&A session.

Questions And Answers

Operator

(Operator Instructions). I would like to mention that today's conference call is being held exclusively for financial analysts and investors. We kindly ask reporters who may be participating in this conference call to please direct any and all questions to the Company's press release -- press relations department. Please restrict your questions to

two at a time. Here, we do have a question from Marcus Siquaria [ph] at Deutsche Bank. Please go ahead.

Q - Unidentified Participant

Hi. Good morning, gentlemen. Just two questions, first on, during the quarter, the Jorge La set up plant generated less than expected. I believe it was some sort of non-extraordinary thing going on there. How much do you expect -- how much in volume did you lose from this plant during the quarter? Then second, on Rio Madeira, talking to other companies in the sector, it seems that the government is working towards setting up good corporate governance standards for the Rio Madeira project. If that materializes, would Tractebel be interested in joining the consortium?

A - Marc Verstraete {BIO 18446542 <GO>}

Okay. With respect to the first question, as you noticed, our costs in the Third Quarter related to the spot price increased substantially compared to last year. And as we said, one of the reasons was lower thermal generation and higher -- as a result higher purchases in the spot prices, at higher prices as well. The lower generation was a -- has two other components, one of them is Jorge Lacerda C where in the month of December, one of the transformers was broken and so the production of the plant was lower than previous months and the other reason is the plant William Arjona, which is a gas-fired plant located in Mato Grosso do Sul in Campo Grande. There, this plant also produced less than previous quarter because some new transmission lines enters the state or reached the city, let's say.

I don't have fear that the excess quantity on an initial [ph] basis that we have less for Jorge Lacerda C fortunately that we can look it up and send it to you. With respect to the second question, Rio Madeira, it is hard to tell -- usually Tractebel likes to participate to projects where it has a control. So here we would have to say okay, what is the model that the government is proposing here in terms of good corporate governance and have a closer look at this. But at this time, the process -- I cannot make any statements here about this.

Q - Unidentified Participant

Thank you. If I may, on the upcoming auction, in addition to the biomass plants that you will place in the process, would Tractebel be interested in some of the PCHs expected to be offered? And what are you expecting in terms of prices for a Estreito plant?

A - Marc Verstraete {BIO 18446542 <GO>}

With respect to your first question, the -- if we would be interested in small hydro plants to be auctioned in the upcoming new energy auction, the answer is no. I think small hydro plants called PCHs in Brazil are not the focus of Tractebel Energia. Tractebel Energia is looking at bigger projects, bigger plants. I think we have the balance sheet, the resources to do so. So we are not looking at any of these small hydro plants.

With respect to the other question, the price of Estreito, well, I don't have -- we don't have any, let's say -- my only expectation is the following that the plant, which is a botox

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plant although -- it is a qualified as a botox meaning that it can participate as new energy till 2007. So it's important for this plant and it's important for us and it's important for the government that these plants really sells its energy in the upcoming auction because it will be the last year that it will able to sell as a new energy. As of next year, it will be requalified as existing energy. But I don't have a final price yet. We are still discussing EPC [ph] contracts, et cetera, to see what we -- what we should reach that we know now that the project recently entered the pack and the new measures announced the government in terms of growth. So this had a impact on financing as well. So we are rerunning let's say our assumptions.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

Excuse me, our next question comes from Mr. Sergio Tamashiro with Itau Bank.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Good morning, everyone. My first question is regarding the sold energy. In the Third Quarter, you sold almost 3,800 megawatts and which increased to almost 4,000 megawatts in the Fourth Quarter, an increase of 161 megawatts. I just would like to understand why such an increase. On the other hand, you had no energy coming from Jorge Lacerda C at least in December, from William Arjona. So what expanded increase in the sold energy?

A - Marc Verstraete {BIO 18446542 <GO>}

The increase in energy sold only comes from energy purchases. Just to remind everybody here, what is driving the revenues of the Company is the assured energy attached to the plants, which I called in the presentation our own resources that we are able to sell. And also the energy that we purchase from other generator -- generating companies. And that we sell. So if we have an increase in energy sold, it's -- in this case, it's due to higher purchases. So it's not related to the physical part of the story, which is higher production or lower production at thermal plants. This does not impact the quantity of the energy sold.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

And -- but I believe that you have made a very short-term contract in the purchase announcement in the selling side. And therefore, could you explain price of each of the purchase and the sales of this energy?

A - Marc Verstraete {BIO 18446542 <GO>}

Can you repeat the question please?

Q - Sergio Tamashiro {BIO 2274485 <GO>}

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I just want to know the average price for the purchase and also the average sales price. I believe that these contracts had very short-term duration.

A - Antonio Previtali

For the First Quarter only?

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Yes, just for this increase as you mentioned that you made this, you saw this trading opportunity.

A - Marc Verstraete {BIO 18446542 <GO>}

Well the --

A - Antonio Previtali

Sergio, it doesn't mean that these contracts were signed during the quarter itself. We had a plan. This plan is made on a timely basis for the short-term, for the medium-term. And it doesn't mean necessarily that we bought at the quarter itself. But there was a decrease on the average price of the energy sold because the contracts, I mean from the Third Quarter to the Fourth Quarter 2006, because of the fact that the trading company of Tractebel found better conditions to sell at higher prices during the Third Quarter rather than in the Fourth Quarter.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Okay, okay. And in terms of this coal thermal plant of 340 megawatts, you mentioned that the CapEx should be around \$850 million. Therefore, it seems to be quite expensive. Therefore, what price are you expecting to sell this energy?

A - Marc Verstraete {BIO 18446542 <GO>}

The reason why it's -- why it seems to be an expensive coal plant is, first of all, the quality of the coal is not so good as for instance, the coal you could-- the international coal you could find in other countries, meaning that you -- you need to spend more on the plant itself in terms of the boiler. It has to be much heavier, et cetera, than for other thermal plants. The final price, Sergio, we don't have it yet because we are really, I would say in the early stage of the project, receiving here EPC contract, receiving financing proposals. So it's still too soon to give an idea of prices here for this project.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Okay. But at least for the coal, you mentioned that this coal had the lowest price per bridge unit. Could you give what price it is or the price of the coal per ton or whatever?

A - Marc Verstraete {BIO 18446542 <GO>}

The coal costs around R\$140 per ton.

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Q - Sergio Tamashiro {BIO 2274485 <GO>}

Okay. Thank you. For this -- coal for this new project?

A - Marc Verstraete {BIO 18446542 <GO>}

Yes.

Q - Sergio Tamashiro {BIO 2274485 <GO>}

Okay. Thank you.

Operator

Our next question comes from Stewart Ragar from Bear Stearns. Please go ahead.

Q - Stewart Ragar {BIO 1506436 <GO>}

Hi. Good morning. My question was back on the spot prices. Spot prices, the energy purchase cost total went up quite a bit just between the third and the Fourth Quarters, even though spot prices were down. Can you explain that?

A - Marc Verstraete {BIO 18446542 <GO>}

I will try. So the -- indeed, if you compare the -- if you compare the costs, we had with the, what we call, CCEE, the Energy Trading Board to reach the R\$88 million in the Third Quarter of '06 compared to R\$140 million in the Third Quarter of -- in the Fourth Quarter of '06. Why this increase? You have several reasons to explain the increase. The first reason is the fact, what I would call, a carryover effect. Part of the cost related to the Third Quarter was only booked in the Fourth Quarter. And so, we are speaking here about R\$20 million. The reason why you have -- when we published our results of the Third Quarter, the Mai [ph] or the CCEE didn't have published its result for the month of September. So September, we had to make an internal estimation and we fell R\$20 million short. This -- so, we have R\$20 million in the Fourth Quarter related actually to the Third Quarter.

Besides this accounting impact, the main driver was lower thermal production. And why was the production at the thermal plants lower in the Fourth Quarter compared to the Third Quarter is part of it because at Jorge Lacerda C power plant, one of the transformer broke down end of November and so you have the lower production in December. And the other reason is for the Arjona power plant located in Campo Grande, where you had -- where they reinforced the transmission lines to the city and you had reduced production at that plant, mainly in October and November.

Q - Stewart Ragar {BIO 1506436 <GO>}

What did you say happened to the transmission lines?

A - Marc Verstraete {BIO 18446542 <GO>}

The transmission lines were -- they built new transmission lines to the City of Campo Grande. So whereas in the past, the City of Campo Grande was really relying on the

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Arjona, our Arjona gas-fired power plant. Now, they -- and which is expensive energy -- which is expensive energy compared to the, let's say, energy in normal situations. Thus, since they have no options, they only have to reduce transmission lines to the city, they have to produce with that energy. We were reimbursed for that because we were not dispatched because the spot price reached our cost to produce with that plan which we were dispatched for inflexibility reasons because they needed the energy, they have no options. So we were fully reimbursed. Now, in the Fourth Quarter '06, they built or they finished building new transmission lines to the City of Campo Grande, meaning that they are able to import cheaper, let's say, energy coming from other parts of the country and they don't have to dispatch anymore these more expensive gas-fired power plant Arjona.

Q - Stewart Ragar {BIO 1506436 <GO>}

Okay.

A - Marc Verstraete {BIO 18446542 <GO>}

In our case, this also means lower fuel expenses, which are not seen in these CCEE expenses. So there is a CCEE expenses increase but on the other hand, the fuel expenses decreased.

Q - Stewart Ragar {BIO 1506436 <GO>}

Okay. Was there a third reason to it?

A - Marc Verstraete {BIO 18446542 <GO>}

No. These are basically the reasons.

Q - Stewart Ragar {BIO 1506436 <GO>}

Okay. Thank you.

Operator

(Operator Instructions). Excuse me, our next question comes from Mr. Marcio Prado with Unibanco.

Q - Marcio Prado {BIO 15398968 <GO>}

Hi. Good afternoon to everyone. Just a question regarding the transfer of Sao Salvador from SUEZ to Tractebel. I understand that the whole price will be R\$300 million. We would like to understand, if we could have a breakdown on -- of this R\$300 million, how much is related to CapEx that already has been made and what relates to pre-CapEx cost when the project was being analyzed due for SUEZ; by SUEZ?

A - Marc Verstraete {BIO 18446542 <GO>}

Again, let me explain here the following. So the Sao Salvador, the project is still owned by SUEZ. They started construction last year and the idea is to transfer the project as soon as possible to Tractebel Energia. Why I am saying as soon as possible because we still need

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to sign the financing with BNDES, which is I would say almost done. And sign the PPA contract with Pulm [ph], which should be done soon also because the auction already took place. Once we have the condition for the transfer okay, then it will be sold. At what price?

You have two components here. First of all, you have the equity already injected by SUEZ which was used to pay the cost, EPC contract, et cetera, to build part of the plant. And so, we will fully reimburse incurred cost and besides that, there should be a premium related to the development and the value of the project -- the value that it will bring to Tractebel Energia. I don't have figures here open, because we just mandated here financial institution to start the valuation of the project but what I can say is that in terms of the costs of the equity already injected, this is around R\$300 million. So the purchase of the project will be R\$300 million more or less being the cost, plus the premium, which is not defined yet.

Q - Marcio Prado {BIO 15398968 <GO>}

Okay. Great. Just when you -- when the process is finished, then if you have this breakdown, I mean you have the breakdown of, what is the premium and what is the equity already injected by SUEZ. But now you don't. That's it -- just sort of just understand.

A - Marc Verstraete {BIO 18446542 <GO>}

Exactly. Exactly.

Q - Marcio Prado {BIO 15398968 <GO>}

Okay. Thank you.

Operator

Our next question comes from Marcus Siquaria, Deutsche Bank. Please go ahead.

Q - Unidentified Participant

Hi, just a quick follow-up, actually a quick question on the personnel and material expenses. During the quarter -- during the Fourth Quarter, the increase a bit compared to the previous quarter, is there any recurring items, non-recurring items in those expenses?

A - Marc Verstraete {BIO 18446542 <GO>}

In personnel?

Q - Unidentified Participant

Yes. In personnel and material.

A - Marc Verstraete {BIO 18446542 <GO>}

No.

Q - Unidentified Participant

No. All right. Thank you.

Operator

(Operator Instructions). This concludes today's question-and-answer session. Mr. Marc, at this time, you may proceed with your closing statements.

A - Marc Verstraete {BIO 18446542 <GO>}

Well first of all, I would thank to all of you for your attention and your interest. I would also like to say that tomorrow morning, we will be doing a presentation in Sao Paulo; tomorrow afternoon in Rio; Wednesday night in Florianopolis, we will have our CEO, Manoel Zaroni, giving the presentation. So if you are able to join, please feel free to do so and it will be a good opportunity to ask additional questions. For those who are not able to join, of course, myself and Antonio Previtali will always be at your -- we will remain available here at the Company to answer any additional question you might have. So once again, thank you very much.

Operator

That does conclude our Tractebel's Fourth Quarter results conference for today. Thank you very much for your participation. You may now disconnect.

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