Y 2013 Earnings Call

Company Participants

- Fabio Bicudo, Chief Executive Officer, Investor Relations Officer, Member of the Executive Board
- Frank Possmeier, Member of the Executive Board, Deputy Chief Executive Officer

Other Participants

- Ali Hedayati, Analyst
- Bernardo Brisoni, Analyst

Presentation

Operator

Good morning. Welcome to ENEVA's Conference Call to discuss the results of the Fourth Quarter 2013 and update of its projects. At this time all participants will be in a listen only-mode. Later, we are going to open up the Q&A session, and further instructions will be given. (Operator Instructions) I would like to remind you that this conference call is being recorded.

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

Fabio Bicudo {BIO 15000971 <GO>}

Good morning. Good morning, everyone. Fabio here. This is my first call with the company. I've been here for a little bit over a month. I wanted to thank everyone for the time and being on the call. I'm going to give you a very few -- a very brief introduction of where we are and then I'll pass it over to Frank Possmeier, who is the Deputy CEO of ENEVA and he'll walk you through the presentation.

A couple of words, these are turbulent times in the sector in Brazil, we are seeing a lot of change. I think from an ENEVA point of view, what you'll see in our results is really our company that went from being a pre-operational company a year ago to now an operational company and you can see that through the numbers.

We're going to talk about also the operational performance of the different plants. We've added some data to show how the plants have operated even in the beginning of this year. I think you'll see that there is a noticeable improvement in where our plants are and their availability and there is a lot of work that has been put behind that, that I think is now showing results. So we'll talk a little bit about the improvement on the operations side and then you'll see that in the numbers.

I think from an ENEVA point of view, it's clear that we have two main challenges. We have a situation around the project Parnaiba II, we've disclosed a relevant factor -- a relevant notice to the market on that. What I can say there is, we have a strategy in place. We've acted on it and we are in active dialog with the regulator to find a solution that I think will be a good solution to maintain this project alive, and at the same time provide us the relief that we need right now. So I'll talk about that later.

The second challenge for the company is capitalization and making sure that we're prepared to resume growth and then we have a stable capital base and that's also a challenge that we are currently engaged in discussions with our shareholders, with our stakeholders and working hard to achieve our plans. So these are the main challenges, I'll talk about them later. Again, we've gone from a pre-operational status to an operational status. We have improvement in the different plants.

With that I'll turn it over to Frank Possmeier, who'll lead you through the presentation and I'll come back later to talk about these major challenges. Again, thank you everyone.

Frank Possmeier {BIO 18083214 <GO>}

Thank you, Fabio. And good morning also from my side. Yes, Fabio, as you said, turbulent times, so turbulent 2013 not only for ENEVA but for the whole energy sector in Brazil. But, despite these turbulent times, I think we are achieving and we have achieved a lot in the past year of 2013. We significantly increased our operational revenues. By year-end, we had an overall operating revenues of R$1.4 billion only in the last quarter of that R$530 million and the main effect in the fourth quarter is that we head up approximately 600 megawatts of additional capacity out of Pecem II, Parnaiba III and Parnaiba IV.

We amounted to an overall generation energy sales of more than 10,000 gigawatt hours in the whole year of 2013, and approximately 4,000 gigawatt hours only in the last quarter of 2013. As you know and very special and separate conference call on this at the end of December shortly before Christmas, we successfully refinanced in the fourth quarter our HoldCo debts and we're able to get additional credit lines of up to R$600 million in order to help the cash position of the company. And we will come that a little bit more in detail later on.

In the fourth quarter and the beginning of this year, we had positive effect and impact also from the regulatory side, we were able to cut off the unavailability charges on an hourly-basis due to a Federal Court injunction that was granted in January and we also granted an injunction on Pecem II and we received last year in the last quarter R$31 million of fixed revenues back from the regulator.

Nevertheless, although we had a good operating fourth quarter, the overall net income and the overall result of the company is amounting to R$940 million of negative net income for the whole year of 2013, and only 280 million of that in the fourth quarter. But here you also have to take to consideration that it was the first year of ramp up for the company, the first year of operation.

So when you take the one-time items of approximately R$400 million of delays, due to delays on fully consolidated businesses, 150 million of that is a bumpy, a 100 million approximately energy purchase and 170 million of lost fixed revenues, if you add the one-time items from the equity reconsolidated company Pecem I of also approximately R$200 million due to the delays and the unavailabilities there.

And the extraordinary write-off of a deferred tax asset of approximately R$120 million and that we did at the end of 2013. The result of the net income would still be negative, but only at around R$250 million for the whole year of 2013. So we were able to bring if we just take the one-time items of really the negative effect and the negative net income down by approximately R$200 million compared to the year of 2013 -- 2012, which is due to really the power plants coming online at the operational performance.

Let me turn to page two, where we look into the net operating revenues in more detail, I think you see here a constant ramp up of the net operating revenues. In the fourth quarter 2013, we reached R$530 million of operating revenues. There we had one-time items to regulatory reimbursement of R$50 million, so the recurring net revenues that we have on the company in the fourth quarter amounted to R$480 million in the last quarter.

Let me now look at the cost and expenses of the company on page four, we are happy to see that with the significant ramp up in energy generated amounting now to more than 2,500 gigawatt hours only in the last quarter. We in parallel see also significant decline in operating cost per megawatt hour. We've started at the beginning of the year of 2013 with R$380 per megawatt hour operating costs per gross energy generated and we were able to bring that down to R$160 per megawatt hour in the fourth quarter. If R$160 is already inflated by non-recurring one-time events, if you would just deduct them, we bring the number down to R$140 per megawatt hour, which is totally in line with our expectations.

The ramp-up you see from Q3 to Q4, from 130 to the number I just mentioned, R$140 per megawatt hour, it's mainly due to Pacem II coming online and the operating costs for our power plants of simply higher than for gas-fired power plants and therefore the 140 is totally in line with our expectations.

When we look at the holding operating expenses, only on ENEVA level we were able to reduce our holding expenses by approximately 10%, exactly 9.6%, but in parallel the cost on ENEVA Participacoes rate.

So, overall, compared to 2012, we have a flat development of the holding expenses, but we are in the process as we outlined last year to significantly reduce headcounts by the fourth quarter of 2013, you see a headcount of 176 employees on holding level and we were able to bring that down now in the first quarter to below 160 people in the holding.

Moving on page five, to the EBITDA development in 2013, a very positive development of the EBITDA for the third quarter and the fourth quarter on a consolidated basis, you see a positive EBITDA for the first time. But the full-year EBITDA on a consolidated basis obviously is still negative with approximately R$90 million, but also here, the same one-time effect that we have to take into consideration and as that are already mentioned at the net income development are true of approximately R$400 million to R$450 million of dump fees lost fixed revenue and energy purchases that we have to do. So taking of these one-time items that would have resulted in a positive EBITDA for the year of 2013 of more than R$350 million, which would have been the normal outcome of this year.

After now looking at the consolidated numbers and the consolidated overview for ENEVA, I would like to go to -- as Fabia also outlined, the operational performance of our single power plant, I like to start with our 100% consolidated power plants and then go to our equity consolidated one. We'll start on page six with the operational performance of Itaqui, we see a very positive development and the availability of Itaqui, we reached in the fourth quarter an availability of 84% translating into positive an EBITDA of R$25 million only in the fourth quarter. But in the fourth quarter there was also a one-time effect that we have to mention, which was the ICB online reimbursement of approximately R$17 million that is embedded in this 24.

When you look at the variable revenues versus the variable cost for the Itaqui power plant, we see a constant decline in the variable cost. We were able to bring it now fully in line with a variable revenues. So we have zero variable margin, which is in line with the structure we see under the PPA, that's the fuel cost and the operating cost should be a pass-through to the consumer.

Moving to the operating -- operational performance of Pacem II, we are very happy with the performance of these power plants only in the fourth quarter last year, in the first three months of operation, we were able to reach our performance and availability of 85%. And in the first quarter 2014, we now could ramp it up to 97% and thereby outperforming even our PPA obligation of 95%.

The positive availability of Pacem II also translate into a very positive EBITDA development for the fourth quarter of approximately R$55 million. Here, we have a very positive variable revenue to variable cost structure and with every megawatt hour we produce. We already made positive -- positive EBITDA contribution due to the performance of the plant.

I will now halt here for a second on Pacem II and not go directly into the next power plant, simply to outline, what does it tell us, when we look at the performance of Pacem II. As you know all of our coal-fired power plants are of the same type, they all are the same generators, they all have the same layout, they all have been constructed by the same team. And when you look at the performance and the development of Pecem II in the last six month, you can see that ENEVA can execute the commission and operate the coal-fired power plant without any problem. And as all of these power plants are of the same type and you see the performance of Pecem II, there cannot be any device failure or any overhaul or underlying problem in the other coal-fired power plant.

So we are able to operate and to commission a power plant and we will also be able to really get over the (inaudible) that we have in the remainder of our power plants on the coal-fired side and we'll bring them all up to the same level of operational performance that we see in Pecem II.

On Parnaiba I, our gas-fired power plant on line since the beginning of last year. We have an overall availability in the last quarter of 2013 of 96% -- we were able to bring that even further up to 99% in the fourth quarter -- third quarter of 2014. So very stable operational performance translating also into a very favorable EBITDA development in the course of 2013. The fourth quarter was impacted by approximately R$18 million [ph] of one-time unavailability costs, thereby bringing the EBITDA down to R$32 million in the fourth quarter. Taking off these one-time items, the number would have been at approximately R$50 million.

Now moving from a fully consolidated power plants to the equity consolidated on Pecem I you see also a very positive trends there, it has been a very difficult year for energy at Pecem, Pecem I in 2013. But when you look at the developments from the third quarter, until the first quarter 2014, you see a ramp up from 64 to 72, there was a dip in the beginning in the fourth quarter, which was mainly due to the first turbine in Pecem II -- in Pecem I being taken offline to repair the hydrogen seal and to assess maintenance for the whole month of December and significant parts of January, but now after that repair we see a totally different performance of the two units in Pecem I.

Also the EBITDA in Pecem I had a very positive development. We achieved a positive EBITDA of R$62 million in the fourth quarter. But as I mentioned, this is not due to the positive performance of the power plant, but it's mainly due to a one-time item that we had in Pacem I, which is the ICB online reimbursement of R$110 million that was paid back to us in December last year.

The operational performance of Parnaiba II that is online since the October, 2013 is also very positive. In the fourth quarter we had an availability of 100%, a decline in the first quarter of 2014, mainly due to the test operation of the first turbine of Parnaiba II, otherwise we would have seen a very reliable operation of north of also 100% for that power plants.

In the fourth quarter this translated unfortunately only into an EBITDA of R$1 million, but was impacted by net energy acquisition cost of R$38 million that was due in the fourth quarter, taken off also this one-time effect, the fourth quarter would have been at approximately R$40 million of positive EBITDA.

That brings us to the cash position of the company on page 11. And at the end of the third quarter, we started with a cash position of approximately R$360 million with positive revenues of R$420 million and the debt raise as part of the refinancing in December, we had R$1.6 billion of funds available for the fourth quarter that was used for CapEx in the amount of R$325 million, operating expenses and costs of R$515 million, debt service so debt paid, amortization and interest paid of R$325 million and intercompany loan that we granted to PGN as the overall transaction to (inaudible) of R$200 [ph] and then ultimately translating into a cash position by year-end of R$280 million.

On page 12, we outlined again the refinancing of our HoldCo debt. I will not go into detail on this one, we had an intense discussion with you in December last year, when we presented to you the overall refinancing, the overall consolidated debt of the company by year-end was R$6.2 billion with positive cash position as I mentioned already of R$280 million.

Finally, before handing over to Fabio, again the regulatory updates, what have we achieved in the fourth quarter and in early 2014. On ADOMP I already mentioned that in January 2014 at the beginning of the year, we filed an injunction for Pecem I and Itaqui that injunction was granted on January 24th, and since then all unavailability charges for these two power plants on whole, we then used the time with Aneel to finalize the negotiation of what should be the right calculation methodology for the unavailability for our power plant and reach the conclusion with them two weeks ago and filed last week then the final request with Aneel for the ADOMP revision and we are very positive that we now in the next four to six weeks, will get a positive result from Aneel on ADOMP and thereby we'll not pay any unavailability charges on an hourly basis in the future and also will be able to claim back the money already paid since the start of the PPA.

I already mentioned the ICB online pass-through, so we were able last year to convince Aneel that the reimbursement criteria for energy acquisition cost shall be revised. Aneel agreed to that in the last year and all the money that was due to ICB online has been paid back to the company already.

On Pacem II, the fixed revenue reimbursement, we see a click window here, on the one hand we have already received last year in October the R$31 million of fixed revenues due, since September 2013 as this was granted by the injunction in October last year, but the outstanding amounts for July and August 2013 amounting to R$48 million. The decisions are pending and we have filed a lawsuit with that and we expect a decision on that in the next three to five years.

That's all to the situation of the Q4 and the full year 2013 from my side. So, I'd like to hand over to Fabio again.

Fabio Bicudo {BIO 15000971 <GO>}

Thank you, Frank. Very quickly, on page and we'll open right after I finish the questions. But on page 14, a couple of quick comments. Capital structure, as I mentioned in the beginning, we are working right now with our two controlling shareholders, with other shareholders and with other stakeholders to finalize a short-term and a long-term plan to strengthen our capital structure. Those conversations are happening as we speak and I'll talk a little bit more about milestone and next steps of when we expect to outline a little bit more the intentions here of the company as it relates to strengthening the capital structure. So those conversations are ongoing.

Parnaiba II, as mentioned here on the page, we filed a request for a postponement in the implementation schedule of that project on March 17. We are in active dialog with the regulator and I'm not going to say much more about that, that's a process that is confidential and we are really going to be careful here about protecting the nature of the case we presented, which we think is a valid case, which we think is a strong case. But really, we have to make sure that it's kept at the regulator level. So we'll be very careful about any disclosure there, but that's a strategy as I said was prepared and is now in execution mode. So we're moving on the Parnaiba II resolution.

In terms of -- and wouldn't call it just cost reduction, but in terms of an overall plan for the company, which includes obviously cost reduction. We also expect to communicate to you that the plan for ENEVA, we will look at reducing cost at the holding company, we will look at optimizing cost at the operating STEs.

We believe, as Frank mentioned earlier, there is a fleet concept that is widely used in other companies around the world that we can further -- that can allow us to further optimize cost at the plant level. But more importantly, other than cost reduction, we will also be talking about the organization about motivating our employees, about stock reward plans. There's a whole number of measures that we want to roll out and communicate to the market that involve having a leaner more efficient, more aggressive ENEVA and those will all come out and again, what I call the plan that will be communicated to you.

In terms of next steps or milestone, when do we expect to come out to the market to talk about that in the last conference I attended, we mentioned that we're organizing an ENEVA Day, so mid-April, we're finding the date now and unfortunately there are holidays right in the middle of that month, but mid-April, mid to late April, we will invite investors on ENEVA Day here, where we will be communicating in much more detail about our plans for the capital structure, the results of we hope the Parnaiba II discussion with the regulator and also the overall plan for the company, which involves cost reduction, but also involved as I mentioned a number of other measures here for ENEVA.

With that I'll pause. I'm sure there are questions and the team on the line, the people on the line will have questions, so I'll pause. Thank you.

Questions And Answers

Operator

Ladies and gentlemen. We are starting now the Q&A session. (Operator Instructions) Our first question comes from Ali Hedayati with Indu.

Q - Ali Hedayati {BIO 4173492 <GO>}

Hi, Fabio, how are you? Just want to ask a quick question on some of the press reports surrounding the Parnaiba II situation. There seemed to be an implication in some of them that there was the possibility of walking away from the plant if you viewed it as getting to a point that it was economic on the unavailability fees. Is that part of the strategy and is there any threshold base for that given that you incur those costs on a monthly basis?

A - Fabio Bicudo {BIO 15000971 <GO>}

Look, Ali. Thanks for your question; thanks for being on the call. I think on the Parnaiba II, again, we'll be very careful about what we say, given that we have an active, we have a filing and we have an active dialog with the regulators and we want to be -- we want to protect here and there was ability to reach a positive outcome and obviously any signaling of what the different options are is the complex undertaking for us here as the management team engage with them. I think all I would say at this point is, we believe we have a number of options that have different consequences. There are very sort of simple alternatives that could solve this in a more definitive way, I'd say we would prefer those and I'd say that's the central path of what we're pursuing.

I think there are other alternatives, which may have different results, including the one you mentioned that would not be ideal, I'd say for ENEVA and for the different stakeholders of the project. So we have, again, a number of options, we have a detailed plan here that is revised on a daily basis. We are confident of the case we presented. But I'd really be very careful here in assigning probabilities or timelines given how sensitive and how important this Parnaiba II resolution is for us.

Q - Ali Hedayati {BIO 4173492 <GO>}

Okay. And if I could just ask a quick follow-up. I notice that relative to the third quarter the negative working capital position, and by negative I mean as in the working capital debit, if you will, as the plant level has decreased significantly. Is that normalized now in your view? Have the plants reached normal running levels of working capital?

A - Frank Possmeier {BIO 18083214 <GO>}

Ali, this is Frank. Hi. Thanks for the question. I think what we see is we have optimized on our coal-fired power stations, our coal purchase and the coal stock, also from an operating cost perspective and thereby, we have now better normalized in our power plants. So we think this is now a stabilized level of working capital for our operating base.

Q - Ali Hedayati {BIO 4173492 <GO>}

Okay. So we shouldn't expect to see any significant amount of money needed from the parent to normalize working capital at the plant level going forward?

A - Frank Possmeier {BIO 18083214 <GO>}

Not that we currently envisage.

Q - Ali Hedayati {BIO 4173492 <GO>}

Perfect.

Operator

(Operator Instructions) Our next question comes from Bernardo Brisoni with Yorkshire Sill.

Q - Bernardo Brisoni

Yes, hi, good morning, Fabio and Frank. My question is just regarding also Parnaiba II on the latest material fact mentioned that you have done a partial hedge on short-term exposure. Could you talk a little bit more on that hedge and how much and at what levels?

A - Fabio Bicudo {BIO 15000971 <GO>}

Hi, Bernardo, its Fabio here. Thanks for being on the call for your question. We're usually very, very careful about any disclosure around hedge volumes and hedge prices, not that we don't want to have an informed investor base, but any disclosure around that really impacts our ability to negotiate in the market and can harm our active trading platform that is out there looking for energy or selling energy et cetera. So, I really reframe here from any details around what we've done. I can tell you it is partial, so it's definitely not a full. On the other hand, I really can't get into any price level discussions, unfortunately because it does impact the ability of our team to continue to operate. So I will withhold that information.

Q - Bernardo Brisoni

Okay. Thanks.

Operator

Our next question comes from Ali Hedayati with Indu.

Q - Ali Hedayati {BIO 4173492 <GO>}

Just another follow-up. Is there any thought process on the progression of the ownership of the joint venture and its eventual merger with the company and how that would look?

A - Fabio Bicudo {BIO 15000971 <GO>}

I'll comment just -- Ali, its Fabio here again. On a practical basis we are operating as one company. So I think the idea around the JV, which happened before my arrival here from a practical point of view is now ENEVA run this as a single company with that the teams together with everyone here is the same force, working as one company. I think from a folding it into ENEVA from a legal standpoint there are few steps that still are required for that to be finalized. So from a practical, again, point of view, we're operating as one company and that also allows us to implement cost efficiencies and synergies with the team. On the other hand, there are few legal steps that are still required for that to be formally folded into to ENEVA and that hasn't happened. Frank, I don't know if you want to complement.

A - Frank Possmeier {BIO 18083214 <GO>}

I think only slight complement to that which is we look at the JV up folding into ENEVA, also from a legal perspective as part of the overall solutions that Fabio mentioned at the end of the call by addressing the capital structure, so that will be something, we will tackle as part of this overall program and then finalize also this last remaining outstanding step.

Q - Ali Hedayati {BIO 4173492 <GO>}

Understood. So we should expect any plan for that that is concurrent with the capital restructuring basically?

A - Frank Possmeier {BIO 18083214 <GO>}

That's correct, Ali. That's correct.

Q - Ali Hedayati {BIO 4173492 <GO>}

All right.

Operator

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>}

Thank you for those who are on the call for the questions. I think as I outlined in the beginning, we've gone from a pre-operational company a year ago to what is now a company that is operating. You saw the indicators for the different plants. I think there's a lot of good work that has been put into bringing those plants to a level that is a level we want them to be at, with Pacem II specifically you saw where that plant is operating and as Frank pointed out, given that the four gen sets are the same. It is really a demonstration that we can have the coal fleet operating at the level of Pacem II, just we need to give a time and continue to implement the measures to bring that again fleet to where we want it to be.

I think on the Parnaiba I, III and IV, you also saw there how reliable and where those plants are, we're very happy with that business model and with the plants themselves. I think on Parnaiba II, we've outlined to you that there's a plan, it's been partially executed. We are in dialogue with a regulator and we hope to have news for you by the time we announce ENEVA Day. Overall, again, we expect to announce a plan for the company that will include cost reduction measures, but also a number of other measures that aim to have, as I described a leaner, more aggressive motivated ENEVA that has the ability to come back to the market in a competitive position and includes also the capital structure, which we are working on with our stakeholders. And again look to announce something to you by the ENEVA Day presentation. So with that, it's really where we are. We hope to see you here in mid to late April as I said to talk a little bit more about the next steps for ENEVA. And where we would like to bring this company. Thank you very much everyone.

Operator

This concludes ENEVA's conference call. Thank you all for joining us. Have a great afternoon.