Q1 2019 Earnings Call

Company Participants

- Eduardo Haiama, CFO, IR Officer & Member of the Executive Board

Other Participants

- Carolina Carneiro, Sector Head
- Marcelo SÃ¡, Associate Director and Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call of Equatorial Energia. 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. Eduardo Haiama, CFO. Please go ahead, sir.

Eduardo Haiama {BIO 7279971 <GO>}

Good morning, everyone. First of all, I'd like to thank you all for joining us in our First Quarter conference call. As for our agenda for today, I'll start the conference call describing the highlight of this quarter. Then I'll comment on our operating financial results, give you an update on the development of the transmission projects. And finally, we will open the Q&A session.

Moving on Slide three as for the highlights for the quarter. In the First Quarter, Equatorial's consolidated EBITDA reached BRL 600 million. This figure was impacted by the consolidation of CEPISA, which already posted a positive result. And also the adoption of IFRS 15 for the (transmission) assets. I'll further disclose this impact on the next slide.

In April, we were able to secure long-term funding for SPVs 4 and 6 with BNDES in a 24-year financing. With this, we have already contracted about 90% of all long-term funding for this project and should soon reach 100%. Also in April, Eletrobras did not exercise its option to have a stake at CEPISA. Therefore, we ended with 94.5% of CEPISA's total shares.

In the recent acquired DisCos, the operational restructuring has already (started) at CEPISA, which posted a positive BRL 35 million recurring EBITDA in this quarter, mainly due to the reduction of more than 40% in manageable costs compared to Third Quarter and Fourth Quarter of '18. At Alagoas, restructuring is also in full motion for the conclusion of the Voluntary Layoff Program and also hiring of third parties in line with our best practice.

As for our sales volume, CEMAR and CEPISA returned to growth, posting 1.6% and 1.1% increase, respectively. On the other hand, despite the positive growth of required energy, CELPA posted another negative variation of 4.2%, mainly due to the more interactive strategy regarding losses and collection.

Moving on Slide 5. Energy sales grew by 1.6% at CEMAR across all segments. This increase is mainly due to 2.1% growth in the number of consumers using the product, mostly residential. And the return to growth of industrial segments fueled by the food, beverage and chemical products. I'd also like to highlight that in this quarter compared to Fourth Quarter, we have added 25,000 clients, classified as low-income consumers, (creating an access) to subsidized tariffs.

On Slide 6. CELPA's billed energy fell by 4.2% in the quarter, explained by the unfavorable weather conditions and the increase in losses through the more interaction (we managed to have had) in losses and collection strategy.

As for on slide -- as for from Fourth Quarter, like I said, we have adopted this more interactive approach regarding loss and collection that impacted volumes. In terms of volumes, the highlight here is the positive growth in industrial segment, boost by the foods, metallurgy and non-metallic minerals industries. I'd also just like to highlight that the required energy grew by 0.8% in the quarter.

On Slide 7, CEPISA's billed energy grew by 1.1%, due to the increase in the number of consumers in the quarter and the average consumption. CEPISA, we have already been able to add 36,000 new consumers, the low income, mainly due to campaigns run by the company in order to have their enrollment in the program, rented them at discounts to their tariffs.

Moving on Slide 8. CEMAR's total losses in the quarter, 17.3%, a 0.1percentage point -- we continue to be below regulatory targets. In terms of non-technical losses over low-voltage markets, it grew by 0 -- by 8.1% -- to 8.1% in the period, still below the regulatory targets. Again, in this quarter, both (quality) indicators, DEC and FEC, continued to be reasonably below regulatory targets, having dropped to 13 hours and 6.6x, respectively.

Moving on to Slide 9. CELPA's energy losses in the quarter, 28 -- 29.2%, a 0.9percentage point decrease in the quarter. And CELPA, like I said before, losses, they were impacted by the new loss combat and collection strategy that I have mentioned. It's also important to remember that according to ANEEL, CELPA is the most complex concession area in Brazil. CEMAR, for example, is considered fourth most complex under the same (ranking). Quality indicators continue to be below regulatory targets for both DEC and FEC.

Moving on to Slide 10. In the Second Quarter reported CEPISA's figures, total losses reached 28.2%, a slight increase from Fourth Quarter '18. Company's DEC increased 27.9 hours, basically due to correction in the measure we made after our arrival. This change should continue to impact the indicator since it's calculated at a 12-month moving average for (inaudible).

Moving on to Slide 12. We show (management) expense. CEMAR posted a 5% growth year-on-year, (favorable) inflation for the same period, while CELPA posted a slight decrease in terms of management expense, amounting to BRL 122 million. As for CEPISA, we were able to reduce its recurring OpEx by more than 40% compared to Third Quarter and Fourth Quarter of last year. It's important to highlight that is the Second Quarter since we took control of the company. The main cause for this drop was the Voluntary Layoff Program that was concluded in the First Quarter of this year coupled with the restructuring of third-party service in line with our best practice.

Moving on to Slide 13. The good cost control shown in the previous slide reflects an EBITDA growth we reported and disclosed. CEMAR posted an EBITDA growth of 20%, amounting to BRL 200 million, basically due to growth in Parcel B growth. As for CELPA, the 27% (sic) (37%) EBITDA growth is based on Parcel B growth and cost control and also the reduction in delinquency. And for CEPISA, in this quarter, we posted very high cost control. We have already posted the first positive EBITDA of BRL 35 million.

Moving to Slide 14. We show the consolidated EBITDA for Equatorial. Equatorial posted BRL 604 million adjusted EBITDA. This figure is considering the results being consolidated under Equatorial for transmission, the new acquisitions. If we exclude by this new asset, (with the) transmission, Intesa, leaving only CEMAR and CELPA (in all the) company, the EBITDA would have reached BRL 403 million or 28% growth year-on-year. It's worth highlighting that Alagoas results should only start to be consolidated under Equatorial results on the Second Quarter onwards, despite the fact that we have already consolidated the balance sheet in the First Quarter.

Moving on to Slide 15. We present the debt amortization schedule and leverage for the company. Equatorial's leverage, considering the full consolidation of its assets, reached 3.8x net debt-to-EBITDA, already including CEPISA and Alagoas, which contributed almost BRL 2.9 billion of additional net debt with close to 0 EBITDA. It should -- it's worth highlighting that this leverage calculation is different from the one we have in our covenant for Equatorial. And in the covenants for Equatorial, we consider the 12 months of the results from the new assets acquired by the group in the period.

In terms of cash position, we ended up BRL 5 billion of cash position, which is enough to cover more than two years of debt maturity. We believe we have a very comfortable debt structure to accommodate CEPISA's and Alagoas' cash needs as well as the future CapEx for the transmission projects, considering that we have secured in the past few quarters most of our long-term debt needs for these investments.

Moving on to Slide 16. We show the main CapEx made by Equatorial. As can be seen, the investment in transmission have picked up in the recent quarters and reached BRL 600 million in the First Quarter, following the start of the construction of all of SPVs. Since the beginning of the development of these transmission projects, we have our expense about BRL 1.6 billion.

Moving on to Slide 18 and talking about transmission. As can be seen, we have already obtained the environmental license for all the projects, except for a very small part of SPV 7. And we have already started construction for all other lines. Also, I like to highlight the evolution of the construction in all SPV, or especially in SPV 8. That's the second longest in our portfolio and the last one acquired in 2017 auction, which has already reached 56% progress.

Moving on to Slide 20. As we expect to have bigger CapEx disbursement following the start of the construction of the lines, it's important to highlight the long-term funding already secured. As I have said, in April, we signed with BNDES financing for SPVs 4 and 6, amounting to BRL 1.2 billion with a 24-year maturity. The only pending funding as of now is the additional funding for SPVs 5, 7. And 8, which represents merely 10% of the total funding needed for the transmission line.

So now we have already secured 90% of the BNDES loan we mentioned, 90% of all of the loan funding for the lines. It's important that all of these efforts secure not only credit but also good returns as this long-term financing is indexed to (IPTA) inflation with the same index of our revenues.

I believe like now we can start the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Carolina Carneiro with CrÃ©dit Suisse.

Q - Carolina Carneiro

I have 2 questions. First, starting with the news that you gave in the press release of the results regarding the -- this PMSO program in CEPISA and CEAL, your expectation of roughly reducing labor force in around 30%. If you can comment and give us a little bit more detail here? Does it goes in line with your initial expectations? Or it's different? And how does it compare with previous layoff programs that you had in the units you acquired back on the date after the privatizations of CELPA and CEMAR? And second question in regards to the tariff revision -- extraordinary tariff revision process for CEPISA, do you have any updates regarding to the process of evaluation of the initial asset base and the request of such a tariff revision process for ANEEL? Do we have any updates on that process?

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Carolina. Regarding the turnaround specifically for CEPISA sale, I can say that it's -- so far it's in line what we expected, maybe a little bit (advanced) towards -- for the First Quarter, Second Quarter, the turnarounds. And that's why we highlighted, right, the reduction we were already able to do in terms of manageable costs in CEPISA, all right? Of course, partly the scrutiny of -- but also part of it's related to the way we hire the third-party service that allow us to have the best practices' buffer efficiency, right? So what I can say is like what we expected to deliver by the time we acquired those assets last year. So far, I cannot say that we are off track. And we actually don't. We are really on track of delivering what we expected.

In terms of the CEPISA's tariff review. It's too early to say. Today, we just had some meetings regarding how should be the methodology to reassess the asset base, right? Remember that we have requested a full appraisal for the asset base. And what I can say in terms of (inaudible) and what we have found so far is like our diagnosis that we made before that -- it's like there are too many assets that we were able to spot, physical assets that for some reason they were not considering direct in the previous tariff reviews, right? So that does give us confidence that we should be able to include some of this in the next tariff review. But to say by how much and exactly which assets we're going to be able or not to include, I believe like I first need to conclude all the assessments, right, in order to really have something firmer, let's say, to say. But it's still like early in the process to provide any kind of guidance regarding this.

Q - Carolina Carneiro

Okay, okay, okay. That's perfect. No problem. Just if you can remind us what's the deadline for this process of appraisal? It's end of May?

A - Eduardo Haiama {BIO 7279971 <GO>}

No. It's June. Remember, our 3rd review is in December. So six months prior, right, to the tariff review we need to conclude our investments to be included in the rev. And the appraisal specifically, probably the date which we're going to have to deliver is going to be in August.

Operator

Our next question comes from Marcelo SÃ¡, Banco UBS.

Q - Marcelo SÃ¡

I actually have 2 questions regarding CELPA's tariff reset. Last week, the regulator disclosed a technical note with the preliminary figures for CELPA's tariff reset. And there are 2 points that are not really clear to me. I'd like you guys to comment if possible. First, even on the energy losses. The regulator is proposing an increase of close to 100 basis points in losses. But I thought that the increase would be higher. So I'd like to understand if there is room to -- for further improvement. And also, in the calculation of the key component of the X factor, there is something that I didn't really understand. It is that the regulator is assuming that CELPA current OpEx is around 100 -- sorry, is around BRL 850 million, which is completely different than the actual cost of the company that should be more in line with BRL 600 million. And this is important because this is part of the calculation of the key component of the X factor. So I want to understand if you think that this calculation could be eventually wrong, of the key component.

A - Eduardo Haiama {BIO 7279971 <GO>}

Marcelo, just exactly -- the second question, what key component? I couldn't understand.

Q - Marcelo SÃ¡

Yes, because in the key component that was proposed is minus 1.18%. But when you do the calculation, you compare -- you can also compare the target of the OpEx with the actual cost of the company. And when there is a difference of above 20%, you need to share part of this difference with the consumer. But then because the reference that (I know) he's using instead of being the BRL 600 million that's actually -- the actual cost is for CELPA, it's using BRL 856 million. Then this ratio is much lower than the 20%. And which means that you don't need to share anything to the consumers. So this is something that was a little bit weird to me.

A - Eduardo Haiama {BIO 7279971 <GO>}

Okay, okay. Well regarding this question is easy to answer. So we know -- in our stimulation, we continue to remain within the 220% BAM -- right, range. So we don't see a change to this scenario in a sense. Regarding the EBITDA losses, the technical one, we believe there are room to improve, right? It's still -- up to now it's, the (, range) probably it's much more cognizant than it was, let's say, (2, 3, 5) years ago. This has to run lots of simulations and very heavy ones. But we believe there's room to improve. And as for the past (recommendation,) like also had their rerun, we remain so far within the 120% range.

Q - Marcelo SÃ¡

Okay. So you think that there wouldn't be necessary to have this adjustment in the key component because you are below this 120%. That's what you're saying, right?

A - Eduardo Haiama {BIO 7279971 <GO>}

Yes, yes.

Q - Marcelo SÃ¡

Because -- okay, okay. Because what I understood is that you had to compare the BRL 600 million with the -- BRL 720 million or something -- BRL 730 million, that would be the target of OpEx. Then if you have more than 120%, then you would have to share that. That's the (cost line), right?

A - Eduardo Haiama {BIO 7279971 <GO>}

Yes. You're right. It's a bit like you get. The actual cost of '16 and '17 adjusted up to the tariff review date, right? You compare that number should what should be the benchmark, right, for you in the range.

Q - Marcelo SÃ¡

The lower range of the benchmark, right? That's -- it's going to be the closest mark. Okay?

A - Eduardo Haiama {BIO 7279971 <GO>}

Yes. It is (inaudible) because we are running below, right?

Q - Marcelo SÃ¡

Yes.

A - Eduardo Haiama {BIO 7279971 <GO>}

And if you are -- if you have -- if you're within 120%, right. So you don't share anything else. And that's the way. So you're right.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Haiama to proceed with his closing statements. Please go ahead, sir.

A - Eduardo Haiama {BIO 7279971 <GO>}

To sum up, we'd like to reinforce our commitment delivering differentiated appreciation to our shareholders for exceptional financial and operating results. We also like to highlight our adherence to the highest-level transparent and corporate governance and reassure that both me and our Investor Relations team are available should you have any further questions.

Thank you, all, again, for taking part in our First Quarter conference call. And have a good day.

Operator

That does conclude Equatorial's audio conference call for today. Thank you very much for your participation. Have a good day. And thank you for using Chorus Call.