

Q1 2010 Earnings Call

Company Participants

- Antonio Previtali, IR Manager
- Eduardo Sattamini, CFO & IR Director
- Unidentified Speaker, Unknown

Other Participants

- Diego Moreno, Analyst
- Gustavo Gattass, Analyst
- Marcelo Britto, Analyst
- Maria Carolina Carneiro, Analyst
- Mariana Coelho, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning. This is Tractebel Energia Teleconference. All participants are connected only as listeners and later on, we will open the Q&A session, when instructions for participation will be given. (Operator Instructions). We should remember that this teleconference is being recorded. Now Mr. Antonio Previtali has the floor. He is the relations manager with Tractebel's investors.

Antonio Previtali

Good morning, ladies and gentlemen. We welcome to Tractebel Energia Teleconference, where we will discuss the results of the First Quarter 2010. This presentation, followed by slides, will be simultaneously transmitted through the Internet, through the www.tractebelenergia.com.br, at section Investors. There you will be able to have a copy of the company's results release.

Before proceeding forward, I would like to clarify that all the statements that may be made during this teleconference regarding prospects -- business prospects of the company should be treated as forecasts, depending on the economic conjuncture of the country, of the performance and regulation of the sector, besides other variables.

With us, Mr. Eduardo Sattamini, Financial Director and Investor Relations and initially Dr. Sattamini will talk about the performance in the First Quarter of 2010. Right after, we have the Q&A session. Now, Mr. Eduardo Sattamini, please proceed.

Eduardo Sattamini {BIO 16648085 <GO>}

Thank you for your participation. Today, we will have the results of First Quarter 2010, which were marked by the low settlement prices of difference PLD and for the financial effects of the inflation pick up, which will be shown in our balance sheet.

Page four, the main indicators of operation. We had 9.9% increase in net operating revenue, due to price volume. As we will see later on, a 22.2% of EBITDA increase, especially because of PLD, because this decreased our expenses with electric energy. We had an increase of six percentage points -- percent points in the EBITDA margin.

The net income, 6.3% above the First Quarter of 2010. It was partially offset by the low PLD and also because of the pick-up in inflation in the effects of monetary indexation, our debts. As to energy sold, 7.8% above, 4.3% average price. The production, we had 44% above the First Quarter of 2010 due to a big drought we had in 2009 and in 2010, we had high rainfall.

As operating highlights in March of '10, the Areia Branca came into operation and this increased 19.8 megawatts to our installed capacity.

Here in slide four, the controlling situation, we are under the umbrella of GDF Suez. Then we will have a shareholders meeting to be called and Tractebel Energia guaranteed at the Estreito consortium the O&M contract, which will account for BRL15 million a year and this is made up by Vale, Alco and Camargo Correa and Suez Energia.

Now slide six. The modification we had from the previous to this semester is the Areia Branca. I mean, the quarter. It's the Areia Branca. The alteration has been made as of the Fourth Quarter of last year.

Slide seven shows you our market share, consolidating our position of the greatest -- of the largest Brazilian energy generator and a consolidator of the generation industry. On the left, we see, since last quarter, we have new projects in our portfolio. At the end of the construction of this project, we will have 8.6 gigawatts of installed capacity.

Slide eight, it's worth noting that in 2010, we start feeling the reflection of a pick-up in industrial consumption in our contracts and if we compare 2010 to what we have forecasted in the Fourth Quarter of 2009, we had an increase in free customers' participation and increase in trading companies and a reduction in the participation of distribution companies from 58 to 56 and this is also due, not due -- so many contracts. But the new contracts -- but the existing contracts.

In terms of diversification of our customer portfolio, we have a diversification policy into several industries and here we present to you the distribution of the main industries where we operate. As we said, the industrial growth will and has already been impacting our results and we expect that in 2010, we will have high GDP growth and this year will be quite promising in terms of the free market.

Now slide 11, we will talk a little bit about the energy market. You will notice that we have changed the chart on the right. Previously we had a chart on consumption and GDP of several countries and this chart is still important.

It's only an annex to this presentation, but we decided to modify this slide in order to strengthen the fact that their recent auctions of their -- of energy will increase the supply for the next years, but will also increase the price of energy in regulated markets, which will reflect in the contracted mix of distributors and use the -- an increase in price for free consumers.

You can see the several charts for small power plants, hydro power plants, flexible and inflexible thermal power plants and the demand line a long time. We can see that along 2010, 2011, we will have this demand line cutting the flexible thermal power plants line, which has generally a more expensive dispatch price. Obviously, this is a snapshot and when we have greater affluence, the hydroelectric power plant will displace the other types of energy and then we will have a little bit more volatility in the short-term market.

Now a little bit of our commercial strategy. We want to trade future availability and we can see on the right chart, this strategy. We always take the year 2013, which is the average. So in 2006, we had 40% of available energy for -- still to be sold in 2007. Then we have 27% of the available energy in 2013. Then, going on, this is a gradual policy, as the opportunities pop up, we will have these changes for future years.

On the left, we see the contracted -- uncontracted energy of our portfolio. In 2010, we had a reduction of 52 megawatts. In the Fourth Quarter, we had still megawatts to be sold. Today we only have 86 megawatts. Therefore, with minor variations.

We will see this in the energy balance in 2010, slide 14, we have minor fluctuations in purchases for resale. It was a slight reduction, 29 megawatts less. We increased bilateral sales, accounting for 23 megawatts. So we have a reduction of 52 megawatts in available energy.

Small variations occurred in the balance, from 2011 to 2015. In 2012, we had 12 megawatts contracted and so forth. Small quantities that are not relevant and this does not display the appetite of new customers and there is some intention to contract other amounts of energy.

It's also worth noting that in this energy balance, in 2010, we started supplying energy from Marshadine [ph] and regulated energy in terms of BRL134.3, which is quite attractive, price wise. In terms of average sales and purchase price, they're in line with what we had in the last quarter of 2009.

Now the growth policy for Tractebel Energia, here the Estreito project, slide 16, December 21st, 2009, we approved the share of 40.7%. And the other partners, Vale do Rio Dose who were 30%, Alcoa with roughly 25% and Camargo Correa with 4.4%. This approval of the negotiation is still being analyzed by BNDES and Aneel. That's a normal process. It's a time consuming process. It should be ratified in our next shareholders meeting.

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You will see a new photo taken on April 6th. It's the weir of this dam and it's followed in the right schedules. It's scheduled to start operating in 2011. The assured energy corresponds to 153 megawatts, which is the allocated portion. It was sold at minus five for 30 years, starting 2012, with a price of 144 megawatt hours, differed to March 31st of this year. I mean, referring to March 31st of this year.

Slide 17 shows you the Andrade distillery project. This will be starting up in May and it will be connected to the power grid. Then it will go from a project in -- under construction to an operating project and you will see this in the part related to company growth.

Page 18, or slide 18, we see the Jirau Hydroelectric project where GDF Suez holds 50.1% and the remaining is 40% for Eletrobras and 20% from CESTE, 9.9% for Camargo Correa and being transitioned to from Cesf [ph]. It had 80% of its energy sold in auction to date's within schedule and installed capacity of the 3,450 with the addition of two new machines and 2,045 megawatts shared energy. Its start-up is forecast for the First Quarter of 2012.

Let us now talk about the financial performance, on page 20. We all have made this first state, the perennity and the soundness of the company's results allow us to grow and enforce our growth strategy. We have strong cash generation and consistent management income that can support our investment program.

As regards Q1 2009, we have here the different drivers of our results. The main ones were the low PLG, the advance of the generation of energy in Sao Salvador and the pick-up of inflation. These were the main drivers that impacted our results in Q1 2010.

On slide 21, you see the trend for the gross operating revenue. The revenue went from BRL955 million in 2009, in Q1 2009 to BRL1 billion 57 million in Q1 2010, a 10.7% increase and when we compare with the net revenue, which grew 9.9%, we see that there was a slight increase in taxes, mainly due to the different regiments for piece [ph] and co-thing [ph], which went from non-accumulative to cumulative in some contracts.

As regards the gross operating revenue, we had the effect of BRL90 million, energy we purchased for resale, an increase to the -- having to do with the relative price of sales, which went to 125 per megawatt hour as compared with Q1 2009. There were no exports in Q1. This also had a negative impact on our gross operating revenues. Also, the energy from Sao Salvador, which was available in advance for -- in 2009, whereas it was going to happen only in 2011.

As regards EBITDA, on page 22, you can see Q1 2010. It moves very much like Q1 2007, 2009, not so much as 2008. The allocation of energy was slightly different. There was a 22% increase in EBITDA and the main driver for this growth was the impact of settlements in the CCEE where in 2009, we had an expense of BRL76 million, so there was a reduction of our expenses by BRL76 million in this item. We also had more energy generated because of the greater rainfall in Q1 2010, which gave us BRL83 million of impact on our EBITDA.

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Exports, there were no exports because of the negative impact, of course. San Salvador had a positive impact of BRL9 million and our normal operations with a positive impact of BRL30 million, which thus gave us a EBITDA of BRL573 million in Q1 2010.

On slide 23, let us talk about net income. It is -- there is a similarity with the Q1 2009. We had a 6.3% increase. This was, of course, an effect of the CCEE because of the low spot price and the quantity of energy generated and this is after tax. There were no exports. Operations contributed BRL16 million and, yes, here we felt the effect of inflation on our financial bottom line. And a pick-up in inflation in Q1 2010 affected us negatively, especially as compared with Q1 2009.

Then the start-up of Sao Salvador, the income to -- the income was -- the interest was capitalized and now it's accounted for as expenses for the project of San Salvador because it now starts to generate revenue. So you have also the revenue that is a counterpart of the interest, which are expenses. We didn't have the effect of something that we had in 2009 and that was the adjustment of the remuneration of a deposit, even in guarantees.

We had a BRL24 million gain in our financial bottom line last year. So because of these drivers, we had a financial result that was BRL44 million smaller than the financial results of the First Quarter of 2009. We had a net income of BRL249 million in Q1 2010.

Now about the quarterly financial drivers, as I said, energy sold in the first graph, on the left-hand side, we sold more energy and also the EBITDA margin from Q1 2009 to Q1 2010, we went from 55% to 61%, basically due to PLD and generation. There was a high rainfall in Q1 2010.

If we compare the EBITDA margin with the previous quarter, Q4 2009, there was a reduction in the margin because obviously of the volumes and mostly because of the energy we had to buy to resell where the margins are a lot smaller.

On slide 25, you will see our indebtedness. We have been saying that the low level of indebtedness has allowed us to take advantage of this moment to grow. This has been proving right. There was a reduction in our indebtedness by BRL200 million. Basically we settled that most -- the most expensive debt we had. There was also a reduction in the total debt-EBITDA ratio.

We still have a cash position that is very substantial, BRL225 million, which will allow us to pay interest on equity capital and dividends, BRL275 million in total. This is the investment we have scheduled and we have a cash position that allows us to operate. Our net debt at the end of Q1 2010 was BRL2.381 billion.

Now looking at the change in net debt, we had BRL365 million relative to Q1 2009, or rather, relative to Q4 2009. The debt increased because of the investments we made in Areia Branca, Sao Salvador and in Unbraji [ph], where we invested BRL30 million. We also had maintenance CapEx and the rest of it, BRL365 million, were for the acquisition of the Estreito made in January 2010.

We also had the impact of the exchange rate variation, which increased, contributed to increase our debt and we also had operational factors that reduced it by BRL200 -- by BRL420 million. There was also an increasing working capital, which reflected the increase in sales and it was BRL213 million and other factors, BRL33 million and we have a net debt of BRL2.381 billion. This is a bit over one-time EBITDA, which is a very comfortable level.

On page 27, you see our debt profile. We have a concentration of debt in 2011 in terms of maturity. Because of the issue of our third issue of debentures for BRL600 million. But this is not really relevant and won't have an impact, since we are going to generate enough -- generate enough cash and should have a small amount in terms of debentures that would have to be rolled over in 2011. This won't have an impact on our debt.

As regards the cost of the debt, only 8% is denominated in foreign currencies, so our exposure to foreign exchange variation is very low. Most of our debt is in Brazilian reais and is linked to the long-term interest rate, which cost is very reasonable.

On slide 28, you will see our investment. We have very strong cash generation that can support our investments. In 2010, there is going to be a small adjustment in the total investment, but a not significant adjustment. Most of the investments will be funded through BNDES funding and part will be funded with our own cash.

As regards the dividend policy, we stress that the commitment is, of the management, is the minimum of 55% of pay-out of the adjusted net income. We have been paying it on a semi-annual basis. On May the 20th, we are going to be paying out BRL194 million on interest -- of interest equity capital and almost BRL82 million in dividends. Here are the slides for your information. I thank you for listening and we will now start the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the Q&A session. (Operator Instructions). We remind you that this audio conference is for investors and market analysts only. Any questions from journalists should be forwarded to the press assistance of Tractebel Energia and that you ask only two questions at each turn. Our first question comes from Mr. Veneto Scangeo [ph] from Credit Suisse.

Q - Unidentified Participant

Hello, Sattamini and Previtali. I would like to thank you for the presentation. My question has to do more with the scenario. I would like to know if you can give some idea of what the expectation of the management is relative to contracting energy in the government auctions, hybrid energy, what is your expectation regarding the demands and the number of projects that may be part of the auction at minus 5%.

A - Unidentified Speaker

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Okay. Let's talk about the auction. There's going to be an auction for reserve energy on June the 18th. We are getting ready with some wind energy projects, approximately 150 megawatts, and our expectation is that we will be successful in negotiating with suppliers and lowering prices to achieve a competitive level of prices.

As regards the projects at minus 5%, the group is assessing some projects. We have some priorities. By year end and Tapajos is one of them, approximately some 3,000 megawatts that we are analyzing. And of course, we are not going to win them all. We are analyzing some 3,000 installed megawatts in these enterprises in the Tapajos and Telespitu [ph] rivers.

Q - Unidentified Participant

And what about Tapajos and the other rivers, are you optimistic regarding the permits? Do you think they can be part of the auction or is it not clear yet?

A - Unidentified Speaker

We have projects in different states. In some projects, we have submitted the environmental projects for the licensing process and all the projects are not so advanced. Some projects will be ready by year end for the auction for new energy.

Q - Unidentified Participant

Thank you.

Operator

Our next question comes from Ms. Carneiro from Santander.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Good morning. I would like to know from you, as regards commercialization -- direct commercialization to free customers. How is the trend there? We saw data on demand. Demand is picking up to pre-level prices or even above that. So what are the prospects regarding the prices of energy for the free market? Are you more bullish? Do you believe that in 2010 we will have indications of better prices than for 2010? Do you have any guidance regarding prices for negotiations in the free market?

A - Unidentified Speaker

Thank you for your question. Yes. We have seen an increasing demand. This has not been translated into new contracts. But yes, we have seen that there have been options, exercising of options in the contracts that we have. This will have a positive impact on the price at the medium to long-term. Thank you.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

And just a follow-on question, AEP has disclosed its expansion plan and some companies have made comments about the fact that you might be going for hydro and renewable

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energy. Some people don't think you're going to be able to implement all the projects you want for this year because of environmental licenses and delays. How do you see that? Are you thinking of expansion in terms of hydro power and renewable energy or is there another estimation of demand, of the time necessary to approve the licenses?

A - Unidentified Speaker

It has been said that some formal projects will be delayed, but the government has been following it from a very close range. And as these projects are delayed, the government should carry out auctions to adjust the client demand. The policy has been to have extra supply on the part of the government and, if the government feels that there is a risk of demand surpassing supply in the medium term, the government will hold the new auctions. This is our understanding relative to this issue. Thank you very much.

Operator

Our next question comes from Mr. Diego Moreno from Merrill Lynch.

Q - Diego Moreno {BIO 16605588 <GO>}

My question is -- relates to the project of the Saval Ocenias [ph]. Did you give it up? Does this mean that the company is going to focus on hydro and renewable energy and not on thermal plants? Or, are you going to take advantage of any opportunities that may arise?

A - Unidentified Speaker

In a way, it's not that we have given up our coal-based projects, but we are taking advantage of an opportunity. Today, we focus on hydro and renewable energy. These are the projects that are more advanced and we see an opportunity to realize an asset that we have in our portfolio. We have other projects that could replace the coal-based project and this is the focus. Today, we are much more focused on renewable energy. We have set coal aside a little bit. But we are looking at opportunities and we might sell the project. Thank you.

Operator

Our next question comes from Mr. Marcelo Britto from Citigroup.

Q - Marcelo Britto {BIO 15393330 <GO>}

Good morning. My question has to do with the allocation of energy. You have a smaller exposure to the spot price in this quarter, although the spot price was lower. This was also the case partially in Q4. So what is the strategy on the line here? Do you expect higher spot? Do you have more hydro power in your mix? Or, was it the exercise of the options of flexibility in the free market that drove it?

A - Antonio Previtali

This is Previtali speaking. The difference of the short position of the company in CCEE in Q1 2010 relative to 2009 was -- the difference was not big. The selling -- the buying

volume was not considerably different. The difference was that there was a reduction by five times of the spot price. So from BRL76 per megawatt hour in Q1 2009 to approximately BRL18 in this quarter. This was the main reason. In terms of -- and as a consequence, the strategy so far is very similar to the strategy of last year, although this year we have a volume from hydro power which is higher, which allows us to have bigger or smaller allocation throughout the year.

I would also like to take advantage of your questions to say that so far the strategy has been working. In the months where the company was short, the spot drive was good for our strategy. This doesn't mean, however, that by year end we will have a global benefit from this strategy. Of course, we need the second part of the strategy, which is in those months when we are long, the stock price should be high. So so far, so good. But there is no guarantee that by year end we are going to have any extraordinary gains based on this strategy, which is based on seasonality. Have I answered your question?

Q - Marcelo Britto {BIO 15393330 <GO>}

What about the exercise of flexibility options in the free market? What's its potential at the end of the year? That is, are people taking the whole volume of contracts with any free consumers?

A - Antonio Previtali

Yes. They are consuming more. They are taking advantage of the upper band of flexibility and as Sattamini said, there is a very favorable expectation for us to come to add new contracts with these higher consumption will put pressure in the sense of meeting the demands of frequency maintained in the future. Thank you.

Operator

Our next question from Ms. Mariana Coelho from Itau Securities.

Q - Mariana Coelho {BIO 16262980 <GO>}

Good morning, everybody. My question regards the Tractebel's growth model in which SUEZ develops the fuel [ph] and then sells to the company. We know that SUEZ has used an auditing collecting feedback regarding this model. So is there any prospect expectation from Tractebel in terms of change of this model and what would be the timeline for communicating the market about this?

A - Unidentified Speaker

Yes, Tractebel and GDF SUEZ are involved in this study to try and understand and meet the concerns of investors and agents regarding this transfer model. We are involving the study several stakeholders from Tractebel and GDF SUEZ, trying to find an answer that assures us that we will keep the continued commitment of Tractebel to add value to its shareholders, as it has been happening in the last few years.

Extraordinary value to that. If we make it the best we've had a total return for investors quite satisfactory and above the market average. The idea of this study, which should be completed within roughly two months and GDF SUEZ and Tractebel will disclose their results at the end of these two months. Yes. Thank you very much.

Operator

Our next question comes from Gustavo Gattass from PTG Pactual.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Good morning, everybody. I had a few questions to ask. But then I lost my focus here. Let me ask first in terms of contracting, when we look at your disclosure of results, we have an increase of 15 megawatts in contract for, I think for 2012, '13 to '14. I know that you don't disclose prices, but just for me to understand the price issue that you see the price trend that you see in these new contracts is it in line with the best ones or is there any weakness or strong number vis-a-vis what the company had indicated in the past?

The second question I would like to say that you've just mentioned the potential result of this study within two months. And we have a situation in which potentially thinking there might be an option meanwhile and then it would be a fait accompli and so could this study have a direct impact even before these two months or is just the future that is being discussed here.

Then my third question regarding Estreito, just to confirm, when do you think it will be actually be consolidated? Then the final moment of payment, would there be an additional price? Or, is that a fixed final price?

A - Unidentified Speaker

First question, the trend in terms of price, we feel a greater demand, but these contracts that were closed were opened in 2010, that they were closed in the First Quarter of 2010. But they were roughly the same prices that we were expecting at the end of last year. So there is no significant change in this respect, although we have seen a greater demand, but there was no price change from the last -- from the Fourth Quarter until now.

Regarding auctions, the auctions that should take place or the auction within these two months that we have mentioned, it's renewable energy auction. These are projects that are born from Tractebel Energia and the change in maturation or improvement that is resulting from this study will not be included within the horizon of this study, therefore, not affecting it. Regarding Estreito, I can't tell you whether there's going to be an adjustment or not as a result of this study that is being geared up.

Today, there is a contracted price that reflects the negotiation from last year, and initially thinking it will be this price. But if studies point at something different, we have not had any access to the results disclosed. In the case of Estreito, it is not considering the studies, only the CapEx variation between the expected CapEx and the actual CapEx since the contract was executed.

Then we should keep an eye on this transaction. Initially, what we had disclosed was what was negotiated in the call from the Fourth Quarter of 2009, we mentioned that within the assessment budget, there was some slack in the budget for possible contingencies. In terms of the transaction value, it's been negotiated.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay.

Operator

Our next question comes from Jugan Mannou [ph] from Software Bank [ph].

Q - Unidentified Participant

Good morning. Going back to the previous question, let's see if I understand it correctly. (inaudible) the transfer will come as in the old model that we used for Estreito?

A - Unidentified Speaker

No, no, no. It's within the scope of the new model that will be released within two months. We don't know exactly -- we don't know what the results of the study will be and not necessarily we want to create this change expectation. This study is being done on an ongoing basis, and so it's being done with, will be discussed, and will be disclosed to the market. But what will be disclosed to the market, it's still too early to speculate.

Q - Unidentified Participant

Do you have any timing for this transfer or will you comment upon these in the next call?

A - Unidentified Speaker

What is the existing model? Well it foresees the transfer of projects when risks are mitigated. And one of the important risks is the schedule risk timing. We know that the main event is the bypass of the river around the weir and it is highly significant for the completion of the work and this will take place around July or August 2011.

Our expectation or forecast is that this is (inaudible) now in negotiations will take place before the end of 2011, beginning 2012. This is our forecast. Way beyond the immediate type of definition that we would have about this issue.

Maybe it's important to mention that this study that is being done is in -- it's an orientation study. It's not a mandatory thing. Let me just give you some directions, some thoughts, some expectations, possible adjustments, or improvements in our process, but it is basically of the guidance or orientation nature.

Operator

(Operator Instructions). Then we close the Q&A session. We'll like to turn the floor to Mr. Previtali for final remarks.

A - Antonio Previtali

Well I'd like to thank the presence of all of you in this call, for the very intelligent questions so we could elaborate on important issues or matters that involve Tractebel Energia's business and we hope to be with you at the end of the first semester. And we are at your disposal through our emails and telephone. And if you have any questions, we will be available. Thank you very much. Have a nice day.

Operator

Tractebel Energia's Teleconference is ended. We thank you for your participation and have a very good day. Thank you.

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