Q2 2005 Earnings Call

Company Participants

- Mario Sampaio, Head of Capital Market and Investor Relations

Other Participants

- Bodi Selfrateres, Analyst
- Gomez Bethelsaka, Analyst
- Gustavo Gattass, Analyst
- Rulianna Yang, Analyst
- Steve Trent, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time we would like to welcome everyone to SABESP's Second Quarter 2005 earnings results conference call. The audio for this conference is being broadcasted simultaneously through the Internet and the website, www.sabesp.com.br. In that address you can also find the slideshow presentation available for download. (Operator Instructions).

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of SABESP's management and on information currently available to the Company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and, therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of SABESP and could cause the results to differ materially from those expressed in such forward-looking statements.

Today with us we have Mr. Mario Sampaio, Head of Capital Market and Investor Relations; Ms. Nadia Maria Marcondes Franca [ph], Head of Accounting. And Ms. Marisa Guimaraes, Investor Relations Manager. Now I will turn the conference over to Mr. Mario Sampaio. Sir, you may begin your call.

Mario Sampaio

Thanks. Well. Good afternoon, everybody. Thank you, very much for the participation in our conference call to discuss the Second Quarter results. Today we will go over a seven slide presentation and review the main events of this period. Once concluded, we will have a question-and-answer session where we will all be able and available to provide further explanations.

Let's move to slide one, which you have on your screen. Here we would like to highlight that the recovery trend for water and sewage billed volumes after the conclusion of our program aiming at water consumption reduction is taking place. During the Second Quarter, we presented a 5.7% increase in comparison to the same period of 2004. Analyzing water and sewage billed volumes for the retail market, we grew by 5.9% in comparison to the Second Quarter of 2004 and remained in line with the level recorded in the First Quarter of 2005.

Note that usually the Second Quarter of the year records at lower volume in comparison to the First Quarter due to the summer peak consumption.

Moving now to slide two, we comment on our revenue performance. Net revenue recorded an 18.5% growth, reaching 1.2 billion in the period. Such increase is a result of the previously mentioned consumption increase due to the conclusion of our program aiming at water consumption reduction and to a 6.8% tariff readjustment in August 2004. However, these factors were partially offset by changes in the (inaudible) legislation which impacted net revenues in more than 59.2 million this quarter in comparison to the First Quarter of 2004.

As for EBITDA, it recorded a 27% increase in the analyzed period and reached a 45.5% margin.

Again, moving to slide three, operating costs and expenses recorded a 9.8% increase compared to the same period of last year. Here we will comment only the main variations in costs during the quarter. We point out that 21.9 million variation in general expenses, 18.4 million in electric power. And 18.3 million in third-party services. As for electric power cost, it recorded a 20.3% growth due mostly to the average -- due to average power tariff readjustments in the period. And just to highlight in the same period, we also noted a drop in consumption caused by the energetic efficiency program.

As for general expenses, it recorded a 93.2% growth, mainly as a result of provisions for contingency along with commercial consumers adding to 13.4 million. Of this amount, approximately 6 million are related to changes in the outcome for already existing legal suits. And approximately 7 million are a result of consumption and update on due amounts. These increases can be considered a recurring expense. Also, included in the total amount is a 4.5 million increase with provisions for general losses which can be considered in this case a non-recurring expense.

The positive aspect in this line is the drop in bill collection, banking fees due to recent renegotiation agreements, along with banks to lower tariffs. These new fees will provide an annual savings of approximately 6 million Reais.

Another important point in the quarter was third-party services which recorded an 18.6% variation. Such increase is due to costs related to the (inaudible) differentiations, call center for the Metropolitan region, improvement and maintenance, (inaudible) project, tariff studies, corporate social responsibility program, strategic planning and management support mechanisms, studies and researches regarding sludge disposal in sewage and water treatment plants. In addition to the water connection, maintenance systems for the Sao Paulo Metropolitan region to global sourcing.

Of this 7.7 million Reais are non-recurring -- what we understand non-recurring expenses.

Now moving to slide four, we will briefly discuss the main items that had an impact on our net income. Net income was favorably affected by 119.1 million (inaudible) growth, mostly explained by an increase in gross revenues resulting from the water and sewage billed water volumes recovering by a 450 million financial expense influenced greatly by the 11.8% Real appreciation versus the dollar in the period and by non-operating expenses that contributed with 12.4 million. These positive variations were offset by higher income tax and social contribution provisions in the amount of 172.5 million, which led to 335.7 million net income this quarter.

Moving to slide five, we would like to highlight that despite the positive effect on our net income from the exchange variation operating income was also relevant for the bottom-line results. As for monetary and financial variations, as you can see, we remain stable and in line with the previous period.

In the next slide, slide six, we will comment on our debt. But before that I would like to point out that 2005 for us was a very challenging year in terms of debt management. In the beginning of the period, we had approximately 1.5 billion Reais of debt maturing, out of which more than 63% were denominated in foreign currency. In spite of this, we manage to capitalize on the favorable market conditions and fully settle the July 28 maturing Eurobond including interest on the last installment, all this with funds raised with a 8th debenture issuance in June 24.

At this time we would like to reiterate that SABESP's policy is to lower its foreign currency exposure, thus reducing its effect on the Company's bottom-line, as well as the risk perception towards the financial market. Once more, that is what we did through the 700 million Reais 8th debenture issuance where the proceeds were used to refinance the $275 million Eurobond reducing in the process the Company's foreign currency exposure by approximately 10% from 34 to 24%.

It is worth pointing out that today the majority portion of our foreign currency denominated debt is owed to international development banks complying for the Company, lower interest rates and longer maturities.

Moving to slide seven, we can notice through the analysis of the 6th, 7th and 8th debenture issuance that despite the great refinancing pressure in 2005 we were successful in expanding our debt maturity into local markets and at the same time managed to reduce spreads.

Well, our debt management strategy has been that of using all available mechanisms in order to capture the best market opportunities to reduce the debt (inaudible) cost and obtain longer and less concentrated maturities. In line with this, since the beginning of the second half of last year, we have been working on developing refinancing alternatives for our debt along with the Capital Markets.

Recently we began searching a credit right investment fund with a baseline condition of 250 million Reais, interest rate maximum of CDI plus 1.25%. But still to be defined through a book billing process and five-year maturity. The resources from this fund will be used to pay out debts maturing throughout 2006. But still on this point, we would like to highlight that the new debt will have a monthly amortization schedule spread out through five years, thus avoiding concentrated maturities but is much more compatible with the Company's cash generation profile and capacity.

Finally, I would like to remind you all that the regulation on the sanitation sector remains under debate. As you already must know, Congressman Julio Lopes of the PT Party of the Rio de Janeiro state, designated writer for the Special Environmental Sanitation Commission, requested the drop of the urgent contingency request for Bill 5296 submitted by the executives to the House of Representatives. And it is a polemic subject that has received 862 amendments. This outcome is an indication that this subject requires a very careful discussion.

As commented in our last conference call, SABESP considered the establishment of a regulatory framework for the sector an important project which should reduce the risk perception of investors in the Company. But should lead to an improvement in our funding opportunities and costs, both essential for the Company's growth and achievement of its corporate goals.

Well, I would like to thank you, finish this presentation and thank you all for your time. And I will get started with the question-and-answer session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Bodi Selfrateres [ph], Standard New York Securities.

Q - Bodi Selfrateres

I just wanted to ask if are there going to be any tariff adjustments this year? Thank you.

A - Mario Sampaio

Yes, there will be tariff adjustments this year. It should be in form anytime soon.

Q - Bodi Selfrateres

Okay. Thanks. Can we expect something similar to what was done in August of last year?

A - Mario Sampaio

The Company has a tariff formula which is on our site. And I think that can give you a guideline on what will happen.

Operator

(Operator Instructions) Rulianna Yang [ph], J.P. Morgan.

Q - Rulianna Yang

You had already indicated in the prior conference call that you plan to revise the CapEx budget for the coming years and that you might be announcing anything regarding that by October of this year. Could you give us for the guidance in the sense of the plan to increase CapEx or you might lower the CapEx going forward?

A - Mario Sampaio

Okay. Just a second. What we can say is that the CapEx that we have announced so far for the year is maintained. And what is projected and we have already informed previously in terms of CapEx for the further years are still those that we can comment.

What was mentioned on the previous call, we will come back to the group to everybody at the proper time with the proper number. And at this time we would prefer to keep the numbers where they are. Okay?

Q - Rulianna Yang

Okay. Thanks.

Operator

(Operator Instructions) Gustavo Gattass, UBS.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Good afternoon. I had two questions for you, actually one regarding regulation. We have seen mention that the whole regulatory picture is put off a little bit in Congress. But what I would like to know is, do you guys see any, let's say, increased disposition on the new minister of cities to actually listen and take in a different proposal and sponsor a different proposal on the part of the federal government?

A - Mario Sampaio

Gustavo, I think it is early for that. In fact, the group that is with the new minister, that is responsible for the sanitation which would be directly responsible for this, my understanding, unless it happened one or two days ago, it has not been defined.

So I think there are two things there. First, the new group is not really in place. So we really don't even know what they will come in if they are going to make any big changes or not. And I think there are still a lot of political definitions going on that we cannot even foresee what would be in front of us. So I think we're in the same scenario you are.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay. My second question has to do with the bills that the state of Sao Paulo basically has with you guys not only related to the pension liability but mostly the other ones in the water bills. What I wanted to understand is, in the past you have had pretty much a consistent way of offsetting bills with dividends. I just wanted to have an idea from you guys if that is changing in anyway or if that is something you plan to change in anyway in the future?

A - Mario Sampaio

Give me a second Gustavo, just a second. Gustavo, just going back to this question on the bill, the bills, the water mills, the system to offset the dividend, that is something that will still be in the works as we mentioned in the previous call. That is part of what we are already in conversation with the state together with the pension issue. So the mechanics should basically be the same. But that does not mean that that is the only way we're going to be working on settling these amounts. But the direction is that.

Q - Gustavo Gattass {BIO 1702868 <GO>}

Okay. If I may ask a last one, if we look at the longer path for SABESP, management had in the past a very very consistent policy of maximizing tax deductible dividends and basically avoiding as much as possible paying income tax.

Last year I understand that you had an extraordinary year (inaudible) from situation multiples on the cash flow side and on the debt maturities that we faced this year. And you guys actually did not play that idea in full.

What I was wondering is, is there a decision from management not to stick to this idea anymore, or should we consider that if you have to pay taxes you're going to try to protect yourself as much as possible?

A - Mario Sampaio

Just a second. Gustavo, I think from the Company's side, from the Company management side, the Company will always propose to optimize its tax during the dividend estimation. So that is what we're going to be proposing. You are correct in terms of the highlights for this year. But again, without giving any guidance. But the year is still to finish. And there is a lot of variations in macroeconomics that can impact us. So the Company will always be at this point providing the best tax optimization it can get in this matter.

Operator

Gomez Bethelsaka [ph], Schroder's.

Q - Gomez Bethelsaka

You talked about some non-recurring items and general expenses and third-party expenses. Could you repeat the amounts please because I did not get it during the presentation?

A - Mario Sampaio

Okay. The non-recurring was 7.7 million on Reais. Yes.

Q - Gomez Bethelsaka

In general expenses?

A - Mario Sampaio

In -- yes. (multiple speakers). Just a second. Yes, third-party services. Yes, with third-party services.

Q - Gomez Bethelsaka

Okay. Just the 7.7 million. Are there any relevant debt amortizations in the second half of 2005, or no, it was just --?

A - Mario Sampaio

No, no relevant. No relevant.

Operator

Steve Trent [ph], Citigroup.

Q - Steve Trent {BIO 5581382 <GO>}

Good afternoon, everyone. A quick question and forgive me if this is a repeat of the previous statement you made. But I was having trouble accessing your presentation.

With respect to future CapEx, I wanted to get a sense as to how you might fund that with -- you guys did a fine job on rolling over the '05 debt maturities. And I am wondering how you would think about funding your expansion CapEx?

A - Mario Sampaio

Well, let's see. Our CapEx for the next five years, we have already secured financing for over 40% of it with multilateral national and international agencies. So you have a good portion of that coming from there.

Obviously the difference to the total CapEx we will still be working even more diligently in bringing in more financing rather than capital market. I think that is our challenge right in front of us to the great extent that we will obviously look at our indebtedness and do not go over where we are today. This is the general guideline we get from our senior management and our shareholders and our owners, controlling owner. And the difference we should be taking from our operations. That is basically how we plan on financing. But again, being very very aggressive on our financing sources. The ones that makes more sense to our investment profile.

Q - Steve Trent {BIO 5581382 <GO>}

Okay. Thanks very much.

Operator

(Operator Instructions). There appear to be no further questions. I would like to turn the floor over to management for any final remarks.

A - Mario Sampaio

Well, again and as usual, thank you very much for your time, feedback, questions. The entire group here is always available. Marisa and the Investor Relations group is available. So feel free to call us. And they are here to provide you with information you need. Thank you, very much.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time and have a wonderful today.