

Q1 2019 Earnings Call

Company Participants

- Mario Arruda Sampaio, SABESP

Presentation

Operator

Good afternoon, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP's conference call to discuss its results for the First Quarter of 2019. The audio for this conference is being broadcast simultaneously through the Internet on the website, www.sabesp.com.br, where 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 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 results to differ materially from those expressed in such forward-looking statements.

Today, with us as we have Mario Arruda Sampaio, Head of Capital Market and Investor Relations; Sylvio Xavier, Head of Costs and Tariffs; and Marcelo Miyagui, Head of Accounting.

Now I'd like to turn the conference over to Mario Sampaio. Sir, you may begin your conference.

Mario Arruda Sampaio

Okay. Good morning, everybody. Thank you for joining the conference call for the First Quarter of this year. Our presentation today, we'll discuss the main events for the period and then as usual, we'll go through the Q&A session if needed.

Let's start with Slide 3. Here we can see a 3.1% increase in the company's total billed water and sewage volume in the First Quarter of this year. The main growth came from the Retail segment, where billed water volume increased by 6% and sewage volume increased by 6.5%, this when compared to the First Quarter of '18. This growth is largely

due to the beginning of operations directly to consumers in the City of Guarulhos, which means that we went from wholesale to retail.

On the other hand and for the same reason, we can see that the water volume fell by 40.8% in the Wholesale segment, this is obviously due to the size and the (represent of steadiness) that the City of Guarulhos had in the wholesale set.

Let's go to Slide 4, let's briefly comment on our financials. First quarter '19 recorded a profit of BRL 647 million over a profit of BRL 580 million First Quarter last year. And the bottom line increase of 11.5%. When compared to the same period in 2018, we can see that this result is strongly influenced by gross operating revenue, which went from BRL 3.28 billion to BRL 3.54 billion, increasing then by BRL 2.54 million or 7.8%, all this mainly explained by the operations of the City of Guarulhos, which began in January '19 and generated an increase of BRL 7.2 million in operating revenues and in addition to a 3.5% tariff repositioning since June '18 and a 3.1% increase in total billed volume.

Net operating revenue increased by BRL 178.9 million or 4.8% in the First Quarter of '19 moving from BRL 3.7 billion to BRL 3.88 billion this year. This lower increase when compared to the gross operating revenue increase was due to a 6.8% reduction in construction revenue due to the construction of S  o Louren  o Production System, which strongly impacted revenues in the First Quarter of '18.

As for costs, administrative and selling expenses and construction costs increased -- all those increased by 4.4%. As a consequence of the highlighted variations, adjusted EBITDA reached BRL 1.55 billion, an increase of 10.4% or BRL 145 million compared to the BRL 1.4 billion recorded in the same period of '18. Important to highlight that the adjusted EBITDA margin in the quarter was 39.8%, compared to 37.8% in the previous year, resulting in a margin of 41.1% in the last 12 months. If we exclude the effects of construction revenue and costs, the adjusted EBITDA margin in the quarter rises to 46.8% in the First Quarter of '19 compared to a margin of 45.4% in the First Quarter of '18. At the same time, the last 12 months margin reached 49.1%.

Let's move to Slide 5. Here we comment on the main variations in costs during the First Quarter of '19. As we discussed in previous slide, costs, administrative and selling expenses and construction costs increased by BRL 150 million or 4.4% compared to last year. If we exclude construction costs, our costs, administrative and selling expenses increased by BRL 157.7 million or 7.9%. The main increases in our costs occurred in: electricity up by 27.5%; treatment materials up by 14.2%; services up by 12% and payroll charges and pension plan obligations and social security charges by 8.1%. The details of this and other variations in costs are available in our press release results for the quarter, you will find it in our website.

Let's move on to Slide 6. Here we provide a summary of the main variations affecting the company's net income in the First Quarter of '19, always in comparison with the same period of the previous year. Net income, as we already mentioned, reached BRL 647 million. Net operating revenue increased by BRL 178 million. Costs and expenses, including construction costs, increased by BRL 115 million. Other operating income and expenses,

including results from the equity equivalent method had a negative variation of BRL 4.7 million. The financial result increased positively by BRL 43.4 million. And finally, income tax and social contribution increased BRL 35.7 million due to the higher tax -- taxable income presented in the First Quarter of '19. This is explained mainly by the increase in operating income due to the beginning of operations and provisions of water and sewage services directly to consumers in the Municipality of Guarulhos.

FINAL

Let's now move to Slide 7. Here, we'll provide you with an update on regulatory issues. As you may recall, in our last teleconference, we commented on the approval by the regulator of a compensatory adjustment of 0.84 -- 0.8408% related to the second tariff revision in addition to a revision and reduction of the X Factor from 0.88% to 0.69%, both to be applied together with an annual rate adjustment in April '19.

In this regard, specifically on April 10th, the regulator authorized the tariff adjustment of 4.7242% composed of the EPCA of 4.5754% minus X Factor of 0.6920% plus the compensatory adjustment of 0.8408%, all this applicable as of the month of May, which means now being applied.

Another issue of great interest to the company disclosed by ARSESP on May 5th were Resolution 865 and 866, both related to the revision of SABESP's tariff structure. Before detailing some points of these resolutions, it's important to emphasize that this is a relevant pending issue in the tariff process, especially considering that the tariff structure currently adopted by the company was established based on Brazilian and São Paulo State social and economic parameters of the '70s. And for this reason and now (that) mirrors the current reality in which we live is absolutely urgent.

In relation to the Resolution 865, this resolution defines the stages and schedule for the revision and implementation of the company's tariff structure. And Resolution 866 addresses the regulatory guidelines to be adopted by the company during the preparation of the studies to determine the new structure.

Note that these 2 resolutions are in continuation to the proposed 2019 and 2020 regulatory agenda that ARSESP published on November 21 last year. Regarding the schedule defined by Resolution 865, in summary, SABESP team must submit by November 6 this year, a proposal for new tariff structure containing an implementation plan. After this, ARSESP must present its preliminary proposal for a tariff structure. This proposal will be submitted to a public consultation and hearing process that should take place by May 19, 2020. And afterwards, at last ARSESP has to announce the final tariff structure by June 20 -- sorry, June 29, 2020.

As for Resolution 866, which as we mentioned establishes the regulatory guidelines, that should be adopted by us to carry out the studies for the preparation of its proposal for a new tariff structure. In summary, this should contemplate the following terms: First, the differentiation in tariffs for sewage collection and sewage treatment; the substitution of the minimum consumption for fixed consumption and the inclusion of a variable tariff according to consumption levels; next point is the segregation of residential and nonresidential categories into individual and group categories; the expansion of social

tariff coverage; the redefinition of tariff progression scales for all categories and within categories; should also have hold a feasibility study on the adoption of seasonable and dynamic tariffs; and last, the elaboration of a tariff proposal for the water and sewage wholesale set.

As you can see, this is a very complex matter. This will require extensive study by the company so that we can reach obviously the best structure within all the required items and standards.

Well we still have slides -- not slides, well, we still have some additional comments on recent developments. I think the first one is, let's start with the discussion on negotiations with the City of Santo Andr  . On May 5 -- May 7, sorry, a next step was made by the Mayor of Santo Andr  . On this day, he sent for municipal legislative approval Bill #20 that authorizes him to sign agreements and contracts with the purpose of regulating the public service of water supply and sewage, ensuring the services are to be provided by SABESP; sign judicial and extrajudicial agreements with the company. Note that this is important for the discussion and negotiation of their outstanding debt with us; establish ARSESP as a regulatory agency; and establish the Municipal Fund for Environmental Sanitation and Infrastructure of Santo Andr  .

The next point we'd like to also comment refers to last night, exactly last night, disclosure by ARSESP via its final decision and the regulation of transfer to municipal sanitation fund. This measure, as you know, is important because it provides exact outline of how to recognize transfers to municipal funds and the revenue of service providers, basically organizes and determines how we should transfer to tariff the funds we transfer to municipality. In this case, the 4% limit on the value of the transfer was (range rated) as it was defined, the interruption of transfer to municipalities that are not complying with the rules of the fund. The financial component to be transferred to tariff will be estimated at the time of the tariff revision. And if any funds are not yet in compliance with the regulation when we sign the contract during the tariff cycle, the transfer will be compensated at the end of the cycle. Another point defined by the agency was the possibility that transfers to the fund could be used as a guarantee for credit obtained by the fund to finance investments undertaken related to the universalization of public sanitation services.

Let's also comment on recent development on the discussion over the provisional measure 868. If you remember on December 28, '18, the former President, Michel Temer, sent to Congress a provisional measure amending the legal framework for sanitation in Brazil, the provisional measure 868. In the joint committee -- as the discussion goes, in the Joint Committee of the Congress, the proposal received many amendments. And on April 25, the (wrapper) 2 of the proposal, Senator Tasso Jereissati released his opinion altering some relevant points of the original fact. This rewording of the conversion bill was approved later on May 7 by the commission and will now go for voting in the plenaries of the House of Representatives and the Senate. And it's expected to occur by June 3. If not voted by this date, it will lose its validity.

Among the amendments proposed by the provision, it's worth mentioning the following: ANA, the federal water agency, new role in defining guidelines for regulating the sector;

maintenance of program contract in the event of changes in state control of state company; also there will be no new program contracts; new contracts will be obligatory concession contract and therefore, subject to public competition bidding processes. It also provides for the regionalization of the provision of sanitation services. The company is monitoring possible changes in the regulatory framework of the sector. And will assess its impact in a timely manner.

Last issue that we would very briefly like to comment with you is the material fact we disclosed on April 26 related to the creation by the Government of São Paulo of a new working group under the State Privatization Program Board to analyze possibilities of corporate restructuring of the company. To be more specific, this new group replaces the previous group that was focused only on the voting structure. So according to the minutes from the meeting disclosed, the new scope was expanded to study all possibilities -- possible alternatives of corporate organization.

So this ends the presentation and the comments. I would like to begin our Q&A session.

Questions And Answers

Operator

(Operator Instructions) Since there appears to be no further questions, I would like to turn the call back over to SABESP management for closing remarks.

A - Mario Arruda Sampaio

Well thank you for your time. And again, no questions now. But any questions any time, please let us know, myself, Angela and the team is fully available. See you next quarter. Bye-bye.

Operator

This conference has now concluded. Thank you for attending today's presentation.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

