Q2 2014 Earnings Call

Company Participants

- Eduardo Haiama, Chief Financial and Investor Relations Officer

Other Participants

- Carlos Herrera, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to Equatorial Energia's Second Quarter of 2014 Results Conference Call. With us here today, we have Eduardo Haiama, Chief Financial and Investor Relations Officer. This event is being recorded and all participants will be in a listen-only mode during the company's presentation.

After Equatorial's remarks, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions) This event is also being broadcast live via webcast and may be accessed through Equatorial's website at www.equatorialenergia.com.br, where the presentation is also being available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via webcast may post their questions on our website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward-statements are based on the beliefs and assumptions of Equatorial's management and on information currently available to the company. They involve risks and uncertainties because they relate to future events, and therefore, depend on circumstances that may or may not occur. Investors and analysts should understand that macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Eduardo Haiama. Mr. Eduardo, you may begin your presentation.

Eduardo Haiama {BIO 7279971 <GO>}

Hi, good morning, everyone. First of all, I would like to thank you all for joining us in our second quarter conference call. As per agenda for today, which you can see on slide two, I'll start the conference call describing highlights of this quarter, then I'll comment our operating financial results, later I'll comment on some corporate updates for the quarter; and finally, we will open the Q&A session.

Before the highlights, I'd like to clarify some procedures regarding the figures presented in the earnings release and in this presentation. I'd like to point that consolidated information reflects 100% of CEMAR's, 100% of CELPA's and 100% of Equatorial Solucoes, which in turn consolidates 100% of Sol Energias' figures. It's important to note that since first quarter 2013, Geramar's figures are no longer being consolidated on Equatorial due to a change in accounting rules. Its results are now being registered only on the net income line in Equatorial's consolidated figures.

So moving on to slide six, in this quarter CEMAR especially sales up [ph], but both strong energy demand growth respectively of 8.2% and 12.8% year-on-year. In the second quarter, energy losses materialized from both companies. CEMAR's losses fell to 17.8% of the required energy and CELPA to 33%. We continue to improve both quality indicators DEC and FEC in both companies.

Moving on to slide seven, Equatorial's net revenue reached R$1.3 billion, up 21% year-on-year. IFRS EBITDA for the quarter totaled a negative R$73 million. And when you consider adjusted regulatory EBITDA, the consolidated amount, R$242 million or a 63.5% increase. In this quarter, Equatorial presented a net loss of R$185 million and also adjusted by regulatory assets and also adjustments, consolidated net income amounted to R$98 million. Consolidated CapEx in the quarter totaled R$286 million or a 84% increase year-on-year.

In August, ANEEL's Board approved CELPA share for adjustment of 34.96% effectively from August 7th. And also, on July 21st, Equatorial's Extraordinary General Meeting, shareholders meeting, approved a new Stock Option Plan, under which potential dilution for current shareholders would be up to 3%.

Moving on to slide nine, we will talk about the electricity market in CEMAR. As we can see, energy demand post strong 8.2% growth in different segments. The main areas out of the 3.7% expansion of the client base and the loss reduction and the increased per capita consumption this year reflect the investments being made in Maranhao.

On slide 10, CEMAR energy losses reduced to 17.8%, below the new regulatory targets set by ANEEL in August tariff review of 19.6%. In this quarter, the reduction amounts to 0.6 percentage point. When you look at the non-technical losses, which reached 12.7% in the quarter, down from 15.9% as financial regulatory target by ANEEL. In this index, we present 1 percentage point reduction quarter-over-quarter.

It's important to mention that, given the low energy loss level that reached by CEMAR, it's natural to expect, of course, in the face of energy loss reduction going forward, while we reassess our loss combat program.

Moving on to slide 11, in terms of quality indicators, both DEC and FEC improved in the quarter respectively by 20% and 1.7%, amounting to 16 hours and 10.7 times in the the quarter, as a result, not only of the investment made by the company in the previous years, but also change in the prevailing procedures.

Moving on to slide 12, energy distribution in CELPA grew by 12.5% in the quarter, mostly explained by the energy loss reduction and also by the connection of 140,000 new consumers in the last 12 months.

Moving on to slide 13, now (inaudible) CELPA's energy losses. The company ended the 12-month period at 33% of total losses over required energy or a drop of 1.2 percentage points compared to first quarter 2014. Non-technical losses over low-voltage market index amounted to 50.2% or a drop of 4.5 percentage points reduction in the quarter. It is worth highlighting that we are now in our third consecutive gain at the loss reduction since we start our loss combat initiatives at the end of third quarter 2013.

On slide 14 we present a continuous improvement in quality indicators in the second quarter that in fact improved by 34% and 30.7% year-on-year reaching 56 hours and 31 times. We can also see that since third quarter 2012, when we acquired the company we have reduced that by almost 45% in fact by almost 39%.

Improved quality indicators in service is one of our core goal since we got control of CELPA and this improvement is also a result of changing some internal procedures and also some investments already made in the grid. It's also important to stress that in the second quarter 2014, we already achieved ANEEL's goals in terms of (inaudible).

Moving on to slide 16, second quarter EBITDA in terms of IFRS standard amounted to a minus R$73 million and we consider debt accrue of net regulatory assets from both CELPA and CEMAR and also adjusted by non-recurring impact in the quarter, net regulatory adjusted EBITDA would amount to R$242 million, or a 63.5% improvement.

The improvement in EBITDA it reflects not only our turnaround being implemented at CELPA that focus on operational and financial results, but also in the case of CEMAR, our focus improve even further of cost control to benefit fundamental growth. This improvement in cost control and coupled with the demand growth has partially compensating facts from last year's tariff review in CEMAR.

(inaudible) both in CELPA and CEMAR, we adjust the result by the fines collected by the government as predicted in the energy purchase contract, which improved the results, without registering (inaudible) regulatory liability in the quarter, despite the fact these fines will be compensated in the company's tariff readjustments.

On the next slide, slide 17, consolidated accounting net loss was R$185 million. However, if you adjust by the regulatory accounting in non-recurring effects, mentioned before, we would have presented profit of R$98 million in the quarter or an increase of 162%.

Moving on to slide 18, represent our amortization schedule in terms of gross debt, Equatorial's gross debt amounted to approximately R$3.4 billion, accounting 1.7 billion from CELPA and 1.7 from CEMAR. By the end of the quarter, Equatorial ended with the cash position of R$1.3 billion and bigger than our consolidated short-term debt of R$842 million.

Moving on to slide 19, we breakdown Equatorial's consolidated net debt, which amount to R$1.1 billion, excluding net regulatory assets and consolidated cash position. As a result, net debt to EBITDA in the last 12 months amounted to 1.2 times. If you adjust net debt in proportion Equatorial's stake in CEMAR 65% and CELPA 96% as shown in slide 20. We reach R$850 million of net debt representing 1.0 times regulatory EBITDA.

Moving on to slide 21, we present our CapEx figures. CEMAR's total CapEx in the quarter amounted to R$95 million or increase of 65%, as in the case of CELPA, total CapEx amounted to R$192 million or 102% growth in the period.

Finally, moving onto slide 23. As I already mentioned, ANEEL approved CELPA tariff present in the 35% effected from August 7th and also in our shareholders meeting last July, we approved the new stock option plan, which could have a potential dilution of up to 3%.

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

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Carlos Herrera with UBS.

Q - Carlos Herrera {BIO 20355147 <GO>}

Do you have a color on third-party services, administrative expenses related to CELPA by survey increased by some R$8 billion year-over-year. And also something similar, but only R$6 million regarding personnel expense related, sales related expenses on the item. Is this regarding, you have any color on this? Please.

A - Eduardo Haiama {BIO 7279971 <GO>}

Thank you, Carlos. Regarding personnel, last year in CELPA, we didn't accrue profit sharing and now we are accruing every quarter that explain the increase from last quarter of -- second quarter last year compared to second quarter this year. So, profit sharing last year, if you remember, we accrued full amount in the fourth quarter, so it would have like a big hit in the fourth quarter last year, when we accrued 100% of the profit sharing. Now we are accruing on a quarterly basis.

Regarding third-service, I'd say like, this level that we reached of R$85 million should be the regular one. So, we should be running around like R$80 million, R$85 million per quarter, that will be the level we expect till year end.

Q - Carlos Herrera {BIO 20355147 <GO>}

Okay. Sorry, I don't know, I understood well in the case of personnel. You mean that there is, these are the trends in accounting from last year, right?

A - Eduardo Haiama {BIO 7279971 <GO>}

Yeah.

Q - Carlos Herrera {BIO 20355147 <GO>}

On last year you took and again I didn't understand.

A - Eduardo Haiama {BIO 7279971 <GO>}

Yeah, profit sharing. Profit sharing is a big component in terms of our compensation. We do well a lot obtained by performance. In profit sharing, last year we accrued the full amount of that expense in the fourth quarter. So, before they performed well last year all the different CELPA. That's why we paid this profit sharing, but we only approved in the fourth quarter.

Now we are accruing an estimate on what we already have been doing every quarter. So, that when you see our fourth quarter results, you're going to see a big increase in terms of cost, as you saw last year, when we accrued 100% of the profit sharing in the quarter.

Q - Carlos Herrera {BIO 20355147 <GO>}

Okay, got it. Also I have a question on the (inaudible) prosecutor those news are appeared today on the press. They are trying to stop the annual tariff adjustment up to 5%. Do you have any color of how these should go ahead?

A - Eduardo Haiama {BIO 7279971 <GO>}

We don't expect to have any kind of impact in terms of that improved tariff readjustment, but fortunately very short period of time could have some noise. But when you look at how the tariff readjustment with the breakdown was, the impact from this order belong to CELPA was an impact of only 1.6%. The remaining part of the tariff readjustment basically pass-through of (inaudible) expense. So, in the sense, I don't think we should have any negative impact coming from development of someone preparing this tariff increase. Even that it has nothing to do with CELPA per se.

Q - Carlos Herrera {BIO 20355147 <GO>}

Okay. Thanks.

Operator

(Operator Instructions) Our next question comes from Carlos Herrera with UBS.

Q - Carlos Herrera {BIO 20355147 <GO>}

Hi, I have another questions on loss rate. How do you expect to evolve in the -- during the rest of the year and maybe for 2015?

A - Eduardo Haiama {BIO 7279971 <GO>}

In both companies?

Q - Carlos Herrera {BIO 20355147 <GO>}

Yes, please.

A - Eduardo Haiama {BIO 7279971 <GO>}

In the case of CEMAR, as we have mentioned, we don't expect that pace which -- the same kind of reduction that we saw until now, basically because we have already reached our low level. And we are reassessing our loss combat program, so that we assure that any reduction we're going to be sustainable. So, in the case of CEMAR, you should expect some kind of pause in terms of reduction.

In the case of CELPA, we continue to address and at the largest our key priority in terms where we need to tackle in terms of operational speaking and the company. So, in terms of reduction, you should expect that we're going to put most of the effort we can to continue to reduce, maybe not at the same pace, but close to the same pace that we have seen so far. But, that's our key priority as of right now. For 2015, it's hard to see how it's going to evolve now, because our plan that we based on our annual estimate like everyyear we set up a plan considering what we have analyzed in terms of the actual -- the current energy losses and how many actually we need to perform in that that given year to estimate how the loss we're going to evolve. So, we haven't done that for 2015 yet, and we're going to probably do that by the year-end, when we're going to have a better picture of the energy loss. We're going to and this year, how can we address energy losses going forward. So, I cannot give you an estimate for sort of 2015, because we haven't yet done the study.

Q - Carlos Herrera {BIO 20355147 <GO>}

Got it. In the case of CapEx, we saw it increased from 17 million from last quarter. Is this due to network expansion effort, right, at both CELPA and CEMAR?

A - Eduardo Haiama {BIO 7279971 <GO>}

Well, in CELPA, probably we're going to expect -- you should expect kind of a same level, a little bit higher for the second half, especially because large -- not the large part, but an important part of that is related to energy losses that we need to address. And we're going to continue to do that until year-end. So, you should expect to a high level in terms of CapEx for CELPA until year-end probably a little bit higher than the first-half.

As for CEMAR, when you look at our CapEx, mostly driven by growth. So, it's our expectation in terms of demand growth that we need to increase the CapEx to -- as long as we continue to see this strong demand growth that we have seen this year and previous years, you should expect, kind of, the same level of CapEx that you saw in the first-half to replicate in the next part of the year. I mean, it's really on the rough [ph] growth.

Q - Carlos Herrera {BIO 20355147 <GO>}

Thanks. Thanks a lot.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Eduardo 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 a differentiated percent to our stockholders through exceptional financial operating results. We would also like to highlight overs the years to the highest level of transparency in corporate governance and reassure that both me and our Investor Relations team are available to help you should have any further questions.

Thank you all again for taking part in our second quarter conference call. And have a good day.

Operator

That concludes Equatorial Energia's audio conference for today. Thank you very much for participation and have a good day.