

Q3 2014 Earnings Call

Company Participants

- Arruda Sampaio, Head of Capital Markets and Investor Relations

Other Participants

- Mike Huffman, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to SABESP Conference Call to discuss its results for the Third Quarter of 2014. The audio for this conference is being broadcast simultaneously through the Internet at the website, www.sabesp.com.br. At that same address, you can also find the slideshow presentation available for download.

We inform you that all participants will only be able to listen to the conference during the company's presentation. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given. (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 results to differ materially from those expressed in such forward-looking statements.

Today with us we have Mr. Rui Affonso, Chief Financial Officer and Investor Relations Officer; Mr. Mario Arruda Sampaio, Head of Capital Markets and Investor Relations; and Mr. Marcelo Miyagui, Head of Accounting.

Now, I will turn the conference over to Mr. Arruda Sampaio. Sir, you may begin your conference.

Arruda Sampaio

Okay. Thank you and good morning everybody, for this one more earnings presentation. We have with us 11 slides, where we would like to discuss the main events through the last quarter. After that, as mentioned already by the speakers we will go to the question-and-answer session. Let's start on slide three where we show the company's billed water and sewage volume. Water and sewage volumes recorded a 3.5% drop in the period as a result of the water consumption reduction incentive program based on its bonus systems and already known to many of you. The decline in billed volume of 4.6% in water and 2% in sewage shows the population strong adherence to the bonus program, which is the best main measure to reduce water demand and consumption in the Sao Paulo metro region, especially in the Cantareira System where the permitted withdrawal in the three reservoirs that make up the system and the PCG water basin is today only 18.5 cubic meters per second when it was 31 cubic meters per second before we initiated this water situation.

Let's move to slide four. Here we will comment briefly on our financial results. Net operating revenue, including construction revenue grew 1.8% versus the same period of the previous year. The gross operating revenue related to water and sewage services not including construction revenue dropped 9.5% in the same comparison. The main reason for this decrease were the 3.5% drop in total billed volume, the 22.7 million drop in estimated revenue due to the lower billing in the period and the payment of bonus related to the water consumption reduction incentive program, what we call the bonus program with a R\$127.2 million impact.

The 3.1% tariff adjustment in place since December 2013 partially has offset these reductions. Cost, administrative selling and construction expenses increased 19.7% in the period. Adjusted EBITDA reached 742 million in third quarter '14 versus 1,043 million in third quarter last year, corresponding to a 28.8% decrease. The adjusted EBITDA margin was 26.3 in third quarter this year versus 37.6 third quarter last year.

Excluding construction revenue and construction cost, the adjusted EBITDA margin was 35.8 and this quarter against 46.4 in third quarter 2013. In the first nine months of the year, adjusted EBITDA margin was 28.9% versus 35% in the same -- in the previous year. Excluding construction revenue and construction cost in the nine month period year-to-date, adjusted EBITDA margin was 37.4% versus 43.6% last year. In the last 12 months that is the LTM adjusted EBITDA margin was 31.1%. If we exclude construction revenue and costs, adjusted EBITDA margin was 40.1 for the last 12 months. Net income came to 91.5 million, 80.7% down compared to the same period in 2013.

Let's move now to slide five, let's discuss the variations in cost again compared to the same period last year. Cost and expenses moved up by 19.7% over 2013 excluding construction revenue and construction cost. Cost and expenses grew 10% or 140 million. The main increases were 53 million or 40% in general expenses, 46.8 million or 9.6% in payroll and benefits, 37.8 million or 16.7% in depreciation and amortization, 23.2 million or 17.4% in electric power and last 16.1 million or 5.6% in service.

All these increases were partially offset by 49.3 million or 178% drop quarter-to-quarter in credit write-offs. For sure, you have much more details on this on our and these costs in our earnings press release in case you would like to begin.

Let's go to slide six and comment on the main variations in the items that affected our net income for this quarter over last quarter 2013, which totaled -- sorry over third quarter 2013, which totaled 91.5 million. Net operating revenue grew by 51.1 billion or 1.8%. Cost and expenses, including construction cost increased by 382.6 million or 19.7%. Other operating revenues and expenses recorded a negative variation of 20.8 million. Net financial revenues and expenses, including foreign exchange variations increased by 217.9 million in the period. And finally, income and social contribution tax declined by 186.7 million due to the reduction in taxable income in the period.

Well, now let's go to slide seven. On this slide, we will update you on the water situation in the Sao Paulo metro region and the measures that Sabesp has been adopting to ensure uninterrupted supply to the population directly served by us. It is worth mentioning that this crisis is the worst in history or more specifically in the 84 year of available records is mainly concentrated in the Cantareira System, which was responsible for supplying water to approximately 8.8 million people at the beginning and now serves 6.5 million people, including our wholesale customers.

On this slide, we show the reservoir levels of the system that supply the Metro region of Sao Paulo, the data reflects the level of the reservoir after the drive period of the year from June to August, which this year lasted until October when the rain -- rainy season usually begins. Specifically regarding the Cantareira System, the reservoir level on November 13 today, yesterday sorry, was 10.8% already and this already includes the 10.7% related to the second part of the technical reserves and in fact this technical reserves act to 105 billion liters of water.

The Alto Tiete System, jointly with the Guarapiranga, Rio Claro, Rio Grande has been used to meet part of the demand of the Cantareira System, those 2.3 million represent that we will talk further on the next slide.

Before in fact, on the next slide, slide eight. Let's look at this, the slide eight gives you an update of the measures that SABESP has been adapting to deal with the lower water withdrawal from the base PCJ water basin reservoirs making up the Cantareira System, which has been reduced as I mentioned already, since March, till today from 31 cubic meters to 18.5 cubic meters. I would like to remind you that at the beginning of October, SABESP signs a proposal to (inaudible) to reduce water withdraw from the Cantareira System from the 19.7 cubic meters to 18.5 cubic meters until April 2015 and we have been withdrawing in fact that difference voluntarily down to 18.5.

In order to offset this reduction in withdraw from the Cantareira System in addition to the measures mentioned above, in November, the company will increase by one cubic meter per second. The treatment capacity of the Guarapiranga system, which will go from 14 cubic meters to 15 cubic meters per second.

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This increase in treatment capacity is sufficient to supply a city with 300,000 inhabitants and at the same time reduces demand pressure on the Cantareira System, so that it will begin in 2015 with a substantial lower water withdraw demand, but we enable it to recover in a shorter period. Now let's remind ourselves of the four main initiatives that we have -- that have allowed us to reduce water withdrawal from the reservoir, the Cantareira reservoir by more than 12 cubic meters per second maintaining at the same time continued water availability to the population directly served by us in the Sao Paulo metro region. First, consumption reduction driven by the bonus program responsible for about 21% of the savings. Second, the water transfers between the Sao Paulo metro region production system, currently accounting for 41% of this reduction.

Third, operational maneuver and investment to reduce water losses Cantareira accounting for about 34% of the reduction. And finally, the reduction in water transfers to two wholesale customer that is the (inaudible) accounting for 4% of the reduction.

More specifically, regarding the transfer of water from other systems to the areas usually covered by the Cantareira System, thanks to that and credit investments made in the interconnection of all the Sao Paulo metro region. Water supply systems throughout the last year and in its recent intensification, it has been possible to transfer water. So that was -- and again more than 2.3 million people that used to be supplied by the Cantareira System are now being supplied by the other water systems in the metro region.

To be more precise of the 8.8 million customers normally served by the Cantareira System, today 6.5 million are being served by this system, one million are being served by the Alto Tiete System, whose population coverage increase from 3.5 million to 4.5 million, one million is being served by Guarapiranga System, whose population coverage will from 3.9 million to 4.9 million and the remaining 300,000 are being served by the Rio Claro and Rio Grande System. We expect the population supply for the Cantareira System will reach 6 million by the end of the year, after the conclusion of many of the plant currently ongoing work.

The combined efforts of Sabesp and the population so far for continued water supply are equivalent to a water rotational rationing cycle of 48 hours with water and 120 hours without water. That is the magnitude of what we're doing without interruption of water.

On the next three slides, we will analyze rain, water inflow in the Cantareira and the Alto Tiete system reservoir -- sorry. And the Alto, the Cantareira reservoir and temperatures in the Sao Paulo metro region.

On slide nine and 10, we will comment on rainfall and water inflow levels in the Cantareira System. As you can see between July and October rainfall was below average for the period and in October this figure was significantly lower than average. November, we are still below average but we will -- we still have 16 days ahead of it.

As a result of the lower rainfall in the period, water inflow in the Cantareira System reservoir as shown on the next slide, slide 10 remain below the monthly minimum historical water inflows recorded in the past 84 years.

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The next slide 11, we show the temperatures in the Sao Paulo metro region. You can see that from July to October, temperatures were noticeably higher than in the same period in 2013. More specifically in October, the highest temperature in 81 years was recorded and now it's 37.8 centigrades.

Slide 12, we will present -- we present a graphic representation of the available water volume in the Cantareira System. As you can see, this system's total reservoir volume is 1.1 billion [ph] -- 1,493 billion liters, 982 billion liters of which are used to recall the useful volume, which is extracted by gravity and 510 billion liters plus what we call the technical reserve, which is extracted by pumping.

SABESP has already accomplished its work and is able to extract the second part of the technical reserve but considering that we're at the beginning of the rainy season. We expect we will not mean to use the total available water from the second part on the technical reserve.

Now let's move on to slide 13. Here, we will discuss the bonus program in further detail, since this is the measure that most impact the company's revenue giving that encourages clients to reduce consumption. And assessment of this program in the Sao Paulo metro region in October shows that 50% of the connection saves more than 20% and therefore reach the 30% bonus.

25 reduced consumption but did not reach the bonus and 25% of the connections consumed more than average compared to the consumption bonus at its title [ph]. These results show the population strong and it rise to the progress even considering a very hard and dry October. I'd like to point out that as of November 1, we are -- there are two new ranges for bonus program, we basically customers whose consumption and reduction falls between 10% and 15% will receive a 10% discount and those who reduced their consumption between 15% and 20% will receive a 20% discount. The calculation is made in relation to the average consumptions between February 2013 and January '14. The 30% discount for users who reduced their consumption by 20% or more is still valid. This change in the bonus program was necessary to adjust it to reward the efforts of those who are saving water and to ensure continued hearings during the hardest month of the year, when it is normal to expect an increase in consumption.

Please note that customers will receive their bills with the bonus those who achieve it publicly starting in December 2014. Now before we finalize, that was our next slide, but before we finalize, we would like to comment on two matters. First is about investments recently announced by the Sao Paulo State government to increase the water supply security for the entire state from today to 2017. And in this plan, it's included four projects that are under SABESP responsibility. One of these projects has already been mentioned by us in previous call. It is the inter-connection between the Piracicaba, Capivari and Juvvadi or we call it PCJ water basin where the Cantareira System is located.

Currently, the project will increase water availability by more than five cubic meters per second, and it has been budgeted at now R\$830 million and is expected to be completed by 2016. There's another project we have also mentioned before. It is the interconnection

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of the Rio Grande system with a branch of a norm maybe of the real begin of river, which should increase the bulk water availability and water treatment capacity both in the 2.2 cubic meters per second, and this has an estimated investment of R\$500 million.

The two other projects that we will be in charge are reused, or to reused the water station, where the reused water from the treatment stations are sent to the bulk water supply reservoir for two system, and then the water and above reservoir, is just the water reservoir will go to the treatment facility, the water treatment facility. That means that the reused water will be diluted into existing untreated bulk water in the reservoir and then collected and treated for human consumption. In these cases investments are estimated at R\$525 million. Note that these investments will not be added to the company's investment plan but we will replace currently planned investments that are today considered to be less of a priority and in such will be postponed for a later execution. The other investments announced by the government are not under SABESP's responsibility but will increase salt water availability in water basins where SABESP operates municipalities or shares the water use.

One of them, sorry, the construction -- is a construction of two reservoirs in the PCJ basin, but now downstream of the reservoirs that are part of the Cantareira System. These new reservoirs should create add an additional 57 billion liters of water reservoir to be utilized for the Companhia city and surroundings.

Finally, and the second matter we would like to share with you is that yesterday, we disclosed the mature fact in which SABESP's Board of Directors authorized the company to request that SABESP's asset published the recalculation of the charters to be applied in December 2014 as permitted by ARSESP [ph] resolution of 484 and in accordance with the resolution by the Board of Directors made on April 16, 2014 all of which was communicated in the material fact of April 17 2014.

It is worth remembering that in April 2014 assessed through the above mentioned resolutions disclosed among other matters, the territory positioning index for the company's first tariff revision cycle and authorized up the company to apply it at the most suitable type in this future. This is a water shortage and the measures we have adopted to encourage water savings in order to ensure supply.

The Board of Directors resolved -- to restore at the same time and dates the both the Board of Directors resulted to solve the applications of the repositioning index until the end of December 2014 at least. Also in the same occasion, the Board of Directors aiming to preserve the company's economic and financial situation, chose to adjust the 2014 budget to 900 million by reducing expenses and deferring investments and then now that was recently increased by 200 million and at this case, most of it in terms of expenses, but totals a reduction in our budget by 1.1 billion for the current year.

Well that concludes our initial remarks, and now we -- I would like to myself and my colleagues to open for question-and-answers.

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Questions And Answers

Operator

(Operator Instructions) And we have a question from (inaudible) of Morgan Stanley. Please go ahead.

Q - Unidentified Participant

Hi, Mario. I was just wondering -- does the tariff increase only in the 5.4% to 4% [ph] or does it all in addition to it, does it also include the inflationary increased it from April 2014 until end of December this year?

A - Arruda Sampaio

Good to ask on.

Q - Unidentified Participant

Thank you.

A - Arruda Sampaio

We are expecting and the estimate will be made (inaudible) is that they bring the 544 value -- to today's current value. And that exactly how might happen, we don't know. But are expected to bring it to current value. Okay?

Q - Unidentified Participant

Yeah, I appreciate it. Thank you.

A - Arruda Sampaio

Welcome.

Operator

(Operator Instructions) And we have a question from Mike Huffman of Rock point Advisors. Please go ahead.

Q - Mike Huffman {BIO 18381736 <GO>}

Hi, thank you for taking the call. The bonus program does it apply to commercial customers as well as residential?

A - Arruda Sampaio

Yeah. Yes it does, Mike. It's Mario speaking. Yes it does. It's applied to all the customers with higher customer base.

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Q - Mike Huffman {BIO 18381736 <GO>}

Okay, so your statistics on the take-up of the bonus program apply across the board?

A - Arruda Sampaio

Yes. With the statistics based on units of measurement. We meter everything we sell. So the statistics is based on the number of meters that are out now. In dependence of anything.

Q - Mike Huffman {BIO 18381736 <GO>}

Great. And I apologize for not knowing all the details here, the next possible tariff adjustment would be next April in 2015 for the next review?

A - Arruda Sampaio

This is what is been established by our (inaudible), the regulatory agent.

Q - Mike Huffman {BIO 18381736 <GO>}

Right. Okay, thank you very much. I'll drop out.

A - Arruda Sampaio

Okay. No problem.

Operator

(Operator Instructions) There appears to be no further questions. Now I'll turn the conference back to SABESP's management for the final remarks.

A - Arruda Sampaio

Okay, thank you everybody for listening to the presentation and we are totally available to take questions. Mike has another question, you are free to call myself Mario or call our Investor Relations Manager, Angela. And in fact, that is valid for everybody. Thanks again and see you next quarter. Bye-bye.

Operator

The conference has ended. You may now disconnect.

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