

Q2 2016 EPM Earnings Conference Call
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Corporate Speakers

- Jorge Andres Tabares; Empresas Publicas de Medellin; EVP of Corporate Finance, Risk Management & Investments

PRESENTATION

Operator: Welcome to the second quarter 2016 EPM earnings conference call. My name is Bianca, and I will be your operator for today.

The host and speaker will be Mr. Jorge Andres Tabares, Executive Vice President of Corporate Finance, Risk Management and Investments EPM group. Before I leave you with your host, let me remind you to take a look at the disclaimer of today's presentation that you will find at the end of the presentation.

Now, I will give the floor to Mr. Tabares. Please go ahead, sir.

Jorge Andres Tabares: Thank you, Operator. Good afternoon, everybody. Thank you for connecting to our conference call. In the agenda, I plan to talk about the evolution of the main current events and our view of the energy market in which EPM operates, a brief overview of progress and our progress, and then I'll go to financial results on subsequent events.

Moving to page 3, we're very proud of the accomplishment of building Guatape cables back to its position and having put the center in operation in a record time. In almost four months, we're able to fully recover the plant. A lot of people involved from EPM; our contractors, authorities, and even government helping us to fix the cable situation, and the Center has been operating normally since June 25 in its totality.

In page 4, we provide an overview of EPM generation in gigawatt hours per day versus the stock price in the Colombia market. And you can see in February, March and April where the blue line goes down, and that's the impact from Guatape. But starting in mid-March, we started to bring inline 25% of the plant every two weeks until we fully recover it, and we have been generating almost our capacity of 30 gigawatt hour per day during July. The impact of Guatape, the gross impact, that is before the recovery from the insurance, is basically the gap between the blue line after the event, going down to very low capacity, low generation and having to buy those kilowatts at very high prices in the spot price. The fact that we could not generate and have to buy energy at high prices is what explains the impact on that Guatape incident.

Page 5, we have estimate the loss in Guatape. We currently estimate that the net impact in EPM is going to be around COP250,000 million; that is the deductible basically from

the business interruption insurance because the cable insurance had a very low deductible.

The June, and it's already indicated in the financial results that I'm going to show you relevant to book \$100 million of value from the insurance companies; we have been already paid that amount. And what's left is the final adjustment process with the insurance companies; we expect that to happen this quarter. And out of that, we expect to receive further \$50 million from the insurance company as part of the final settlement of the claim.

I highlight also that the Superintendency of public utilities in Colombia charged us with a formal investigation a few weeks ago regarding this case. When EPM reached the allegation from the regulator, we're very confident that we are in compliance with all the regulations. We will provide the answer on our defense through the Superintendency in due time; supposed to start this week and we expect that process to be resolved this year.

Turning to page 6, also to provide a summary of the El Niño for EPM in terms of our ability to generate energy and the losses that we suffer, and that in April; since May we have not been impacted effectively by the El Niño. And I highlighted on the top chart on the right-hand side how the – basically the Colombian system, which is the blue line, basically normalized since March that it really came online with the red dotted line, which represents the El Niño from the 97, 98 season. And I have also to say that for the last three months, the rainfall has been below average and the EPM portfolio has been greatly impacted than the Colombian portfolio, and the rest of the hydro system in the Colombian market.

That lack of rainfall back to normal levels is not going to have an impact on EPM because, as you can see on the bottom chart, our aggregated reservoir level is almost in line with an EPM typical year. The reason for this is because the lack of rainfall has been compensated by the water accumulated in Guatapé during the incident of the cables. The total system in Colombia is slightly below the average from a typical year. We do not expect that to have a meaningful impact in energy prices in the near term.

On page 7, we wanted to highlight the summary of the impact from El Niño. In the middle of the page, you see COP678 million, which was the total impact divided between 2015, when it started, until April of 2016. The main impact of El Niño for us was related with the thermal plant. The hydro system was, okay, we could generate less energy than in the regular season. That would represent losses because of our conservative contracting policy for our generation portfolio. We were not exposed in the generation of hydro due to contracts.

I move to page 8; an update on the ISAGEN events and the ISAGEN's disposal. [The Group] already launched the tender offer; that was in July 24. EPM accepted the offer on July 26. Following Colombian securities regulation, we have to wait until the tender is closed and then settled. We expect that to happen during September. So EPM will receive COP1.48 billion on that date.

Going to page 9, I'm explaining the energy market situation. The accumulated commercial demand during the first semester in Colombia, it increased by 1.7% and we represented 24% of the total demand of the country; that's in the distribution side. Going back to Panama, the market is growing at 5.2% and our share was 35% [and let's keep this to – sold out of it in] Guatemala where it grew 6.8% and we were able to deliver 31% of the demand in the country.

Going to the bottom of the page. When you look at our total portfolio, we delivered 7.856 gigawatt hour during the semester, and that represents an increase of 2.1%. I highlight EPM portfolio, which grew 1.4%.

I'm going to the international companies. The demand was slightly moderated to 2.4% compared to previous periods in which the demand was at the 4%, 5% and 6% levels, and that's mainly explained by the COMEGSA reduction of 16%, and also by the DEL SUR in which the demand decreased by 2%. In this (inaudible) case, Guatemala and El Salvador, we are facing some competition that precluded us from growing at the regular levels.

Going to page 10. In terms of the stock price and the energy price; here, we have two different stories. In Colombia, a significant increase in our stock prices at 79%, which is due to the hydro, the energy matrix and the significant portion of hydro generation that we have in Colombia. And we see a different picture in the rest of the country, Central America and even Chile, where the energy matrix is more associated with the hydrocarbon and prices, the oil prices, and we see reductions of 32%, 55%, 27% and 30% and 32% in Guatemala, Chile, El Salvador and Panama, respectively.

Our actual generation reduced by 13% and we were able to generate 6.7 gigawatt hour during the semester, and that's a 19% share of the Colombian market. Part of this reduction is compensated by the business interruption in Chile that we have related to the Guatapé. And on a different scale, Cururos, the generation also was reduced in 159.1 gigawatt hour. And in Bonyic, we grew slightly to 1.6%.

Moving to an update of the project on page 11. I think this is one of the most important news of the conference call. As of June, the total progress of Ituango was 54.4. We have invested \$4.7 billion in the project. During this year, we have invested COP600 million and the excavations are mostly done. The northern part of the powerhouse is completed, the southern part is at 95% completion. And the spillway excavation is at 72% when the total excavation represents 40 million cubic meters of water. This project is massive. We are at 36% of the dam construction. And as of now, we expect that the project is going to be on-time and on-budget, delivering the first energy to the country in November 2018.

This is frequently asked in page 12, we provide an overview of the financing of the Ituango project. I highlight that almost 38% of the total cost of the project is already financed. Not all of it has been disbursed and it is available to disbursement. We have

disbursed [COP2.3 billion], which is 28% of the project's total cost. And we are under negotiation of another facility of \$550 million with the IBD that we expect to close within the next six months.

On page [three], an overview of the macro scenario in the countries that we operate. In this case, we are showing the countries from left to right from the most representative, of course Colombia, and then the following [days], and the total investment that we have in those countries.

The story on the local currency based with dollar is relatively dissimilar to Colombia and Chile and it goes into other direction to Mexico with still significant volatility in exchange rates. I also highlight the high inflation in Colombia that at the end of June, it was 8.6%; this is higher than what most analysts expected. We do expect that it's going to go down to what we call in Colombia normal levels; that is going to take 12 to 18 months for it to go down.

Moving to page 13 and the financial results. I have to say that these results are somehow distorted by the fact that we're still pending some recovery from the insurance company. As I said, we expect to have around \$50 million of additional recovery from what it is recorded in the June closing, which is represented here. And with these figures, we see that our EBITDA is going down by 12% in the semester. If we account for the insurance for the \$50 million of insurance recovery, we will be slightly below last year's EBITDA. We are forecasting that this year's full EBITDA is going to be around 10% higher than the 2015 EBITDA. This was COP3.6 billion. And the margin shown in this graph, again, are net representative of the long-term situation, and we expect that the margins by September will normalize, at least for the Guatape incident, and they are going to incorporate at that point some five months of normal operations after El Niño.

In page 15, we wanted to provide quite a bit of detail because of the high energy prices, the top-line, the total revenue of the Company, which is slightly distorted by those high energy prices. So we wanted to show you specifically on the lower part of the page, [in the EPM parent] company, how despite that cost of rendering services, which in most part is passed through to our clients. When you look at the personal services, all the different contracts, the increase is 10%, which is slightly above inflation.

We are under an important effort to control costs in a relatively high inflation environment that we're living through in Colombia. The 24% increase in the taxes contributions, [losses] and general expenses, the significant portion of it is COP76 million due to a non-recurring revenue for the contribution of a road in the [CLK Department] where EPM operates.

On page 16, I highlight that EPM has been able to run its capital program at full normalcy. We have been investing very heavily, and you can see in the graph the significant investments we have done in Ituango. We have invested in the semester COP278 million. The total investments as of June are COP1.5 million, and we expect the total investments for the year is COP4.5 billion.

I Highlight also in our investment portfolio the significant diversification of the portfolio where we have EPM got closer to the bigger one in the on the pie in the bottom right in the green one, but also we have also investments in the Colombian power subsidiaries, international subsidiaries. And we are about to finalize our Claras wastewater treatment plant in the [Meridian] valley.

Moving to page 17, I start in the top right. Our EBITDA, just COP1.7 billion. If you normalize this by the insurance claim pending, it will be COP1.9 billion. We put that in perspective last week [going to take] the full year. So we are slightly above in the semester expecting an even much better second half of 2016. In the comprehensive income, we're showing COP593 billion, and I highlight that the international power and water subsidiaries represent 17% of that income.

In page 18, you see an important element of our strategy, which is the international diversification. And here for the first time, wastewater and waste management represent a significant portion of 22%, and the most significant addition to that figure is the delivery from Antofagasta -- from [other than] Antofagasta; our Chilean water sanitation company.

In page 19, we see the balance sheet changes and the equity remained almost flat. Liabilities increased by 5% and that's basically associated with the partial disbursements of the club deal we announced in the end of December of 2015, from which we have disbursed \$560 million, and that is we have yet to disburse \$440 million of that facility. And the 2% increase in assets mainly explained by the infrastructure projects under development, which represent COP950 million. Both total debt and financial debt increased. Part of this is due to the investments in projects, and part of it is because of the temporary impact of Guatape and the impact from El Niño.

Our EBITDA to financial expenses stands at 30.5%, and our debt to EBITDA stands at 46%. This is higher than the 3.5% that we have as covenant with the three multilaterals; AFD, IBD and JBIC. We've got waivers from IBD for 2016, and we are in the process of executing the final documentation for the JBIC and AFD waivers for the June 2016 figure that you are seeing on the screen. And the most important aspect is that our debt to EBITDA ratio is expected to go to 3.5% during the first semester of 2017. We want to run the Company in the long run below 3.5% in the debt to EBITDA ratio.

Page 20, we have our typical debt profile. We highlight here that the maturity that you'll see in 2019 and 2020 that may seem relatively high are associated with the fact that Ituango is starting in 2018, at the end of 2018. So that its cost generation will provide an important source of funds if we want to pay down that debt; only half on 2019, \$500 million, you see almost all the green part of the chart in 2019, and we are [completing that to deliver] those \$500 million. The maturity of the debt is 5.7 years; the average term of the debt.

This being the first full year and the first semester that we have ADASA, we wanted to show you how the Company is progressing, and the results are very positive. Our EBITDA in the January to June when comparing 2015 to 2016 showing is 38% increase, and the comprehensive income is reduced at 1%, basically, due to the level of strategy, the financing strategy that we decided for ADASA.

We are also asked about the UNE situation. UNE is our telecommunication company in which we have 50% that is operated by our partner, Millicom. And the Company is also doing a very good job; the EBITDA is growing at 2% and we still are showing negative net income basically due to the high depreciation required for the Company, given the massive amount of investment it has. And in the CapEx, we have invested COP383 million with an increase of 7% compared to the same period last year. So the Company is investing to renovate its technology in order to be able to provide clients with a more broad range of services than what [was] possible with the previous technology that we had installed.

And finally in page 23, I highlight a few relevant issues for the Company. (Inaudible) resigned to the Board of Directors in May for personal reasons. He was replaced – or is going to be replaced by Carlos Raul Yepes. Carlos Raul Yepes is an independent member and was before the head of Bancolombia. He received a recognition from the National General Accounting Office in Colombia for his contribution to the development of the Colombian accounting system and what we have done related to the IFRS implementation.

[Our board listened for us], given the huge efforts we undertook to be able to apply and implement IFRS one year before the Colombian regulation required it. And in the last couple of weeks, we signed a \$300 million credit loan with EDC from Canada. This amount of money is not expected to be disbursed this year and we have 12 months to disburse fully. I highlight also that this is the first operation we have with a Canadian company, and the fact that it is a government agency helps and supports our diversification strategy in terms of our funding sources.

With that, I would like to open it to questions. And Operator, I'll go back to you.

QUESTION AND ANSWER

Operator: (Operator Instructions) At this time, we have no questions. I would like to turn the call back to Mr. Tabares for closing remarks.

Jorge Andres Tabares: Thank you very much. We can wait for another two minutes in case somebody comes up with a question. And while we wait, I'd like to highlight again that it's our best interest to have as much information in the public and the investors. So feel free at least to contact us directly. If you have follow-up questions, you can connect to us through our investor relations officer.

Operator: Roy Yackulic from Bank of America.

Roy Yackulic: You mentioned that despite low rainfall in the last three months, that the Genco sector wouldn't be normalized. Is that assuming normalized margins for Genco?

I think EBITDA is still a bit low. And you said it's because that you had not been utilizing Guatape and had been increasing the storage being Guatape. How long will that cover things and is the rainfall continuing to be below normal?

And then, what do you think is your biggest risk this year? I mean, we saw last year the impact that were kind of unforeseen events, maybe not El Niño, but Guatape, yes. And then local currency movements and we saw a large increase in leverage. So what are the risks? One is, how much can Guatape support us in terms of water in the reservoirs for the Genco business this year, for how much longer? And what's your biggest story of risk now for the rest of the year and into 2017?

Jorge Andres Tabares: On the second question on kind of Guatape and the rest of it; our Guatape reservoir is now at 50%, and that's a very comfortable level. Our total reservoir level is at 40%. So we don't expect to have any kind of water reservoir issues at least for the next 12 to 18 months.

In fact, there is some probability assigned to La Niña, which then could further improve things. The rainfall, specifically, I may be biased by the August figures, but the rainfall in our reservoir during August is at 50% of the normal. So the country is at 76% for the rest of the country. So it's not an extreme situation; I just wanted to point at the graph that the recovery in terms of rainfall has not been followed the same pattern that it followed in the 1997, 1998 season.

Roy Yackulic: So is that the biggest risk of still hydrology and rainfall?

Jorge Andres Tabares: No, I'm sorry if I gave you that message, no. We are comfortable with the reservoir levels and rainfall levels; we expect margins to go back to relatively normal levels over the remaining of the year. In terms of the risk, although still significant volatility in Colombia that we have managed to hedge significant portion of our US-denominated debt; we have secured in this semester hedges for more than \$500 million.

So basically, as of today, we can say that the total disbursement of the club deal is hedged, and that is important and that basically addresses one of main risks that we saw at the beginning of the year. In terms of other significant risks, I cannot point to one particular one. I think it's very important for us to continue developing our infrastructure projects and, of course, Ituango is the most significant one. Being able to progress Ituango as we have been is extremely relevant for us. It will not have an impact this year nor next year, but the impact in the long-term is so relevant that any delays in Ituango are very, very high on our risk profile.

Roy Yackulic: The moneys to be received in September from ISAGEN; I think there was a statement in the press release that said they were going to be for dividend disbursements. Is that correct, and what was the total of that?

Jorge Andres Tabares: Yes. We are going to achieve our one-time payment of COP1.38 billion. And from that, we are going to transfer to the municipality [COP150 million] every year starting this year and for the following four years.

Roy Yackulic: So it's about 43% of it is going to be dividend into municipality probably. Something like that, yes.

Jorge Andres Tabares: Likely lower than that.

Operator: (Operator Instructions) Mr. Tabares, it seems like we have no further questions at this time. Any closing remarks, sir?

Jorge Andres Tabares: No. Again, we're very open to any further questions. Let us know.

Operator: Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.