TRANSCRIPT

Fourth quarter and full year 2018 consolidated financial results conference call

EPM Group

Operator: Good afternoon. My name is Hilda and I will be your operator for today. At this time, I would like to welcome everyone to the fourth quarter and full year 2018 consolidated financial results conference call - EPM Group.

All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session. Thank you for your attention.

Mr. Jorge Tabares, Executive Vice President of Corporate Finance, Risk Management and Investment of EPM Group will be the host and speaker today. Mr. Tabares, you may begin your conference.

Jorge Tabares: Good afternoon and welcome to our 4Q 2018 results. We will also talk about the full year 2018 results.

On page two of the published presentation, we have the agenda that we plan to cover and we will open it for questions at the end.

Moving to page three, some of the relevant events of the year. We highlight that we made investments for 3.5 billion COP. This is mostly to improve our service via investments in our infrastructure.

At the end of the year, we put into operation the Aguas Claras waste water treatment plant and with that we reached a total coverage of 84% of treatment of all the waste water of the metropolitan area of Medellin before the water reaches the Medellin River and goes to the Atlantic Ocean.

We also contributed to the environment by preserving 21,282 hectares of forest in Colombia.

In the year, the EPM Group received loan disbursements for 2.5 billion USD. The most relevant disbursements are listed in the page and we also received 575,000 million COP from local banks.

We signed after the Ituango contingency credit lines for 750 million USD with international banks in a transaction led by HSBC and 1 billion USD with Bancolombia, one of the most important local banks.

We had a very good result in terms of net income and with that we will be able to transfer to the municipality a total of 1.3 billion COP that are mostly employed by the municipality to develop social investment programs around the city.

We had a difficult year in Ituango, with technical, social and environmental challenges, but we ended the year with a clear view of the possibilities of continuing the project, and putting the project into operation within the next three years, which is our current schedule.

Moving to page four, in terms of the energy market we grew in all of our operations, highlighting that in Colombia we delivered 16,977 GW/h during 2018 and that represents a

7.7% growth over 2017. This is a very solid growth led mainly by non-regulated contracts that we were able to secure via our commercial efforts.

On the right side of the page, in the international operation we also grew 1.6%, with the main growth delivered in the Grupo Deca in Guatemala with 2.3%.

When we combine the results in Colombia and international, our compounded growth delivered a 5.4% figure, reaching a total of 26,715 GW/h during 2018.

Looking at the top of the page, in Colombia we increased our market share by about 1% compared to 2017, reaching a figure close to 27%.

In Colombia, the total economy delivered a solid energy demand growth of 3.3% and when we look at the figures in Panama, El Salvador and Guatemala, our market share remained basically stable from 2017, but I'll highlight that Panama showed slower growth than 2017, reaching 1.8% and El Salvador and Guatemala actually increased their rates of growth, delivering 1.2 and 3.2% respectively.

Moving to page five, the spot prices in all countries where we operate grew during 2018 mainly due to the combination of increased fuel prices and the hydrology in the countries.

Growth in Colombia was moderate. It reached 8.6%, with a total of 39 USD per MW/h.

In terms of power generation, we grew by 2.6%, producing with our equipment 15,838 GW/h during the total year 2018, and we also grew in Cururos and Bonjic, although those figures are smaller in our relative scale of portfolio.

The combination of higher volumes and higher spot prices supports the growth in the financial figures that I will talk about later in this presentation.

Moving to page six, the 3.5 billion COP that we invested are an important step towards improving our infrastructure across the portfolio. All of these are organic investments that will help the reliability of our services to our customers. They create redundancy and they also improve the equipment that may be coming out of its useful life.

Ituango is the highest percentage of that investment, with a total of 1.4 billion COP. In EPM we invested 935,000 million COP and that's an important growth from 2017.

In the international subsidiaries we invested 620,000 million COP, mostly in Guatemala, Chile and Panama.

We pushed to put into operation the waste water treatment plan of Aguas Claras. We invested 149,000 million COP, a lower number than in 2017 in the rest of the Colombian power subsidiaries, with a total of 344,000 million COP. Most of the investment is in the power sector with 77%, while in the water business we invested 23%.

This investment in our infrastructure is a core part of our strategy and we made significant progress with this level of investment during 2018. This also will help fuel the growth of the company over the next few years.

Moving to page seven, inflation was moderate in most of the countries in which we operate, except Mexico, with the annual variation slightly higher than the rest of the countries. I'll highlight that the currencies in the two key countries of operation, Colombia and Chile, showed important depreciations, with 8.9 in Colombia and 13.08 in Chile. This had an impact in both the value of our international funding and the asset value of the international operations.

Going to page eight, in terms of our financial results, I will focus on the January to December numbers.

The headline here is that it was a very good year in every metric. Revenue grew by 9%, driven by the combination of more clients, higher tariffs, and the fact that we are investing in our portfolio and that allows us to increase tariffs across the portfolio.

Our Ebitda grew by 8%, reaching a total of 5,100 million COP. This is the highest Ebitda level in the group's 64-year history.

Finally, the net income at the group level reached 2,400 million COP, with a 4% increase despite the challenges presented by currency depreciation mentioned before, the impact of the Ituango situation, and also the provision that we had to make in some labor issues that we expect to result in the next year or two.

The 2,400 million COP number was supported by significant efforts in cost control. We delivered a total of 421,000 million COP in savings against the budget. This was one of the core actions we took after the Ituango incident to protect the net income and the transfers to the owner.

In that figure, we also had an impact due to the currency depreciation of 264,000 million COP and the total provisions, when we combine Ituango and labor issues, are close to 525,000 million COP.

Most of that provision is non-cash. The cash component of the Ituango incident during 2018 was 69,000 million COP, so this is slightly slower than 25 million USD. That was the total cash impact of the Ituango contingency.

The provisions that we made during the year, we expect to be monetized over the next two or three years. We will disclose that in due time.

We also had a positive impact from the Colombian tax reform that lowered the corporate tax rate and that delivered a positive impact on net income of 285,000 million COP.

When we look at the margins, they were reduced slightly. The Ebitda margin was reduced from 32 to 31%, and the net income was reduced from 16 to 15% at the group level for the full year.

Going deeper on the cost savings program, I'll say that if we normalize the growth of the cost at the group level, the total growth was at 8% when we eliminate the Ituango incident.

When we look at the gross numbers, the total growth that we are showing is 13% in total expenditures at the group level.

Going to page nine, a relatively typical year in terms of the composition of the income and results across the portfolio.

I'll focus on the middle on the Ebitda chart. 64% of the Ebitda came from EPM operations. 15% was delivered by our Colombian power subsidiaries, and 15% by the international subsidiaries.

In the composition of the international portfolio, that 15% of the Ebitda, 35% came from Guatemala, 31% from Chile, and Panama delivered a 24% figure.

Moving to page ten, when we look at the composition by business, the power distribution business contributed the most, with 60% of the revenue and 41% of the Ebitda. This is the business where we are more diversified and operate in more geographies, in four countries in Central America and five different states in Colombia.

The generation business delivered 34% of the total Ebitda of the group and the combined water business delivered 18% of the Ebitda at the group level.

When we look at page 11, all the portfolio is delivering positive results and growth, with the most significant contribution determined by the size of the circumference we have here on page 11.

EPM, Adasa, Essa and Deca are the most representative assets in the portfolio and every single business is delivering to the results.

Moving to page 12, we show the compounded growth for the Ebitda over the last four years, 9.1%- 16, 17 and 18 are purely organic growth figures, with only a non-material acquisition in 2018 of EP Rio, the water business in Rionegro near Medellin.

Perhaps one of the most important graphs of the whole presentation is in the bottom of page 12, where we see that most of the businesses contribute to the 8% growth in Ebitda. Distribution showing a solid 181,000 million COP growth and the small reduction in the transmission business is related to accounting effects and some non-recurrent issues that we expect are not going to be present in the following years.

Moving to page 13, at the end of the year the group had a 22,000 million COP equity and that's growing 6% over the previous year. Our total asset base ended up at 52.500 million COP, showing an 11% growth.

When we look at the asset growth over the last five years, we are showing a 5.8% CAGR, which is one of the key elements of our strategy, investing in our infrastructure and growing it, delivering positive results from those investments.

In terms of the leverage level, the financial debt as a percentage of the total asset base represented 41% at the end of 2018, with a 3% increase. This is due to the level of investments that we mentioned earlier and the fact that for a few years we have been and will be cash flow negative, in order to support the Capex program.

This Capex and this financial debt increase is not only related to Ituango, as we mentioned in a detailed manner in the Capex profile shown earlier.

In terms of our total long-term debt to Ebitda, the year ended at 3.86. Our stated long-term growth is to be at or below 3.5 on a sustained manner and when we normalize that leverage reducing our cash position or the net debt to Ebitda figure at the end of the year was 3.46.

This is due to the solid cash position in which we ended the year. We had 2.6 billion COP in cash at the end of 2018.

On page 14, we show the profile of our total debt portfolio. Here from the 3.2 billion USD maturities in 2019, as some of you may have seen, we paid earlier than the maturity a 500 million USD bond that is shown here in the first part of 2019, effectively reducing that demand from cash during 2019 very significantly.

The average term of the debt portfolio still above 5.5, which is a figure that we plan to maintain over the long run.

The total unhedged exposure is 32% of the total debt portfolio and during the year, as mentioned in the ratios before, we increased our debt level by more than 3 million COP.

Moving to page 15, I'll give you an update on the Ituango project. Given the recent developments, I'll talk about the most recent status of the project, so this is not the status as of December, which corresponds to the rest of the information in the presentation.

As of today, we continue the dam to the full height of 435 meters above sea level. The dam at 418, which was the previous level, was completed in its totality and it's working per designed specifications.

The spillway system was tested for 47 days last year and it's being currently used in the long run. We maintain continuous monitoring of the spillway and everything is behaving within designed parameters.

On February 5, as disclosed to the public, we stopped the water flowing to the powerhouse and since then we have been reviewing every element of the system to determine what the damages were and we are progressing on the design of the solution for each one of the damaged areas of the project, in order to put the project into operation by 2021.

What we have found since we closed the powerhouse, water flow is very positive in terms of the visual inspections of the total roof system. In none of the caverns there were detachments, and this comprises the transformers cavern, the main generation caverns, the basin north and south, and the access tunnels, so in the main cavern system we don't have detachments of the roof, which would have created the most complicated fixing problem, because the roofs are too high.

We have found severe damage on the floors and we have some focalized areas of damage in the powerhouse cavern system.

We found two detachments on the access road to the powerhouse, one of which is significant, and we have already identified the design by which we are going to fix that to provide access to the main road, but in the meantime we expect also to access the powerhouse via the discharge channels that are not being used and we will use those as road access to expedite the reconstruction of the damaged areas of the powerhouse and the caverns.

We have found severe damage on intakes five to eight that we are still working towards diagnosing the design and we plan to continue working on that until the end of July or so, before we take actions to fix that section of the project and the void that we have found between intake tunnels one and two, we are in the process of finalizing the design to fill that void with aggregated material, sandy material in order to eliminate that void and restart the construction of the intake tunnels.

We continue trying to close the two tunnels that have not been blocked with proper engineering. The right tunnel and the auxiliary tunnel have been blocked naturally. They have had constant levels of infiltration water for months now, and we're making significant progress towards the closure of the auxiliary tunnel using the originally designed gate.

We plan to close the first gate within the next month or so. That will allow us to improve the safety of the communities downstream. The communities are currently evacuated, assuming a hypothetical case of the two tunnels unblocking naturally at the same time, which is a very unlikely situation, but one that we are prepared for, just to be on the safe side.

It's taking longer to close the right diversion tunnel. It's a more complex engineering solution, and we expect to complete that work by the end of the year or early 2020, but the initial stages of that engineering design implementation will allow us to reduce significantly the risk for the communities and we expect that they can go back to their homes at some point in 3Q 2019.

We are about to discover the full cavern complex. We have been evacuating water for a couple of months now, and we are removing accumulated material. We have found a significant volume of accumulated soil and rock material on both the south basin and the south part of the powerhouse cavern, so we are about to finish the removal of water, the pumping of water, and are about to starting the removal of sandy material that has been accumulated there.

In terms of the dam, we are now continuing to build the dam to the total height. At this point, we have put 98.2% of the total dam material.

Moving to page 21, we expect that the total cost of the project is going to be 14 billion COP, this is with 1.7 billion of additional direct cost and 800,000 million COP of capitalized interest, due to the delay of the start of the project.

We highlight that these figures are approximate. We continue working on the final design of the solutions for the damaged areas, and as we progress, we will be able to publish and communicate to the market a more accurate figure of the total extra cost of the project associated with the damages.

Moving to the insurance, the two major claims here, one is related to the civil liabilities, these are related to the damages to the communities downstream associated with the flooding that the project generated on May 12, 2018. On that policy, we have a total coverage of 50,000 million COP, and we received on December a confirmation of coverage, so we will be paid by the insurance companies, and we are in the process of settlements and payments to the affected communities, and we will make the financial claim to the insurance companies, so this was a positive development from the insurance perspective.

Moving to the construction risk policy, we are working towards the confirmation of coverage, still working on the discovery and investigation phases. EPM finalized the external investigation of the root cause of the tunnel failure on April 28. We published that to the market at the end of February. Our analysis puts us into coverage, based on that root cause analysis. We expect that the insurance companies' analysis led by the adjuster jointly appointed will be finalized within a few months, as most of the technical information has been already shared and extensive visits by the adjuster and the technical team have been made to the project.

We're working simultaneously to the cost analysis and coverage issues in two work fronts. One is related to the accounting of the extra cost and the repair cost, in which we have engaged with the adjuster extensively and have by now a common understanding of the accounting system and the expenditures that have been incurred in repairing the damaged areas.

We are also working in the delay of start-up assessment. This has two fronts. One is confirmation of schedule issues and the other one is related to the energy market and prices. With those two elements resolved, both parties are going to be able to determine the amount of the coverage associated with the delay of start-up or the opportunity cost associated with the incident that we had in the auxiliary tunnel back in April 2018.

In summary, we have reduced the risk significantly and are continuing to work on the risk in the project in order to give as much safety to the communities as possible. We understand that the technical challenges to fix the problem are significant, but there are technical and engineering solutions when we look at the global knowledge base and we have engaged a contractor who has worked in similar issues in the past around the world, so we are optimistic about our ability to deliver the project.

Our schedule points to 2021 at the end, having the first phase of the project fully operational and we will confirm that schedule and cost in the next few months and as we make progress, we will continue disclosing to the market what we resolved and the decisions that are made to move forward with the project.

Moving to the divestment plan, we have made progress in all three divestments. Starting on top of the page, ISA. We were at the end of stage one period two weeks ago, but after the 2018 ISA results were published, the share price went up significantly so we had to suspend that stage one. We will reassess the minimum price at which the shares will be offered to the market and restart that divestment in the next month or so, so effectively that significant price increase of more than 20% impacted us with a three-month delay of the ISA divestment.

On the positive side, we have confirmation of interest by some international investors and will continue working with them towards progressing on a possible transaction and facilitating their analysis, which in the ISA case is easier, given the listed nature of the company and the information is publicly available.

In terms of Adasa, we are getting ready to launch the initial stages of interest and formalization of interest by parties, and then we will be asking for a non-binding offer at the end of the second quarter.

We have confirmation of many international players, some of which are already operating in Chile, and some that intending to enter the water business in Chile.

The most advanced process is the Cururos sale. We will launch it in the next few weeks, but we have already signed NDAs with many players that are interested in acquiring this asset. That should be the one that moves faster, now that we have delayed a few months the ISA process.

Moving to the Capex program in 2019-2022, this is the key of our strategies, investing in our portfolio. In this chart we show figures in US dollars to facilitate your understanding. The 3.1 billion USD that we are investing are a significant number for our Capex profile, and you can see that the main numbers are in the first two years, so 1.1 billion and 953 million USD for ’19 and ’20, and most of that investment is in the transmission and distribution and water businesses, which are fairly stable businesses for us and which regulatory regimes are constructive and create value for us.

The funding sources to support that Capex program, we have currently signed and to be disbursed 771 million USD from which 450 are part of the loan led by IDB Invest, 71 million USD from BNDES in Brazil, and 250 million USD which we call a facility which is known in syndicated among six international banks.

In addition to that, we have access to the capital market, both international and local, and we have offers and credit available from both international and local banks, so given the lower Capex profile for 2021 and 2022, that will allow us to reduce the leverage over the next few years after 2020.

That ends our prepared conversation. With that I want to open the question and answer session. Operator, it's up to you now.

Operator: At this time, I would like to remind everyone, in order to ask a question, please press * and then 1 on your touch tone phone. If you wish to be removed from the queue, please press the # sign.

We'll pause for just a moment to compile the Q&A roster.

Once again, please press * and then 1 on your touch tone phone.

We have a question from Alejandra Andrade, from JP Morgan.

Alejandra Andrade: Hi, good morning. Thank you for the call. Just one quick question. In terms of new funding sources, given that you're taking out your bond, are you leaning more towards potentially tapping capital markets again, or you just rely on banks for your Capex and no longer have capital markets in USD? Thank you.

Jorge Tabares: Thank you, Alejandra. We basically are funded for the year and we have money yet to be disbursed from our multilateral and international commercial banks facility signed and available facilities. Any potential transaction in the international capital markets, we have not decided. If we end up doing something, it will probably be in USD, and more focused towards liability management operations, as opposed to new funding needs for delivering our Capex program.

Alejandra Andrade: Great. Thank you.

Operator: Thank you. Once again, if you have any question, please press * and then 1 on your touch tone phone.

I would like to read the question that we received via e-mail. The question reads, "Could you give me more detail on how you achieved Ebitda growth?"

Jorge Tabares: Thank you. This is a key element of our performance this year and in fact for the last three years, in which we have had Ebitda growth by 14, 12 and 8% respectively over the last three years.

We're growing in terms of new clients that helped deliver higher quantities, and also because of our ability to increase tariffs. That's associated to the investment program we have been executing basically in all jurisdictions in which we have operations.

In Colombia, we grew in total by 370,000 new connections, so these are clients by service, so one client could have up to three connections. 370,000 in total and internationally we grew 63,000 new connections, which corresponds to 2.6%. That's part of the source of the growth, and in terms of tariffs, if we were to have a weighted number on the Colombian market, the total tariff increase number will correspond to 10%.

Part of that is associated with Capex, as I said, and part of it is due to higher energy prices compared to last year, as pointed in the presentation earlier.

Internationally, we were able to grow tariffs by 4.6% on a weighted basis, so the Ebitda growth is actually the combination of growth across the business and associated with both number of clients and the quantity, the volume delivered to those clients.

Operator: Thank you. We received another question via e-mail. The question reads, "What are the main uncertainties to recover Ituango?"

Jorge Tabares: Well, thank you. We're in the final stages of assessment. At least the preliminary assessment of the condition of all the underground structures. We have yet to enter the south basin chamber or cavern. We have seen it through a camera, and we know that the ceiling has no detachment, so the ceiling is intact, but we have not been able to determine the total damage of that cavern.

We also have yet to remove the accumulated material. As I said before, it's quite significant on the south cavern, also we have soil and rock accumulated so that's the first part of the uncertainties, the extent of the damage.

We're also identifying possible solutions to fix the focalized damage areas, mainly in the intakes, the intake gate, the structure that is in contact with the water, with the reservoir, and then the intake tunnels, the vertical tunnels that conduct the water to the generation units.

Those are the two key damaged areas that will require fixings, so as we have not come up with a final design, I'll say that the uncertainties are related to total cost, and perhaps to a lesser extent, in terms of schedule, the time that will take us to fix and when we combine both or when we finally determine the level of damages, we'll have more certainty. We expect that to happen at some point in 3Q.

Operator: Thank you. There are no further questions at this time. Mr. Tabares, do you have any closing remarks?

Jorge Tabares: Thank you for participating in the call.

As a summary, the group continues to deliver growth that's funded in capital discipline and in cost control that we have implemented since the Ituango incident.

In Ituango we have a much lower level of risk and the uncertainty now relates to actual cost and time to fix the focalized damaged areas.

Thirdly, we continue our intense Capex program that will help us to have reliable and good quality services in the long run.

Thank you and I'll talk to you in the next quarter call.

Operator: Thank you. This concludes today's conference call. You may now disconnect.