Transcript

First Quarter 2019 consolidated financial results

Operator: Good afternoon. My name is Silvia and I'll be your conference operator today.

At this time, I would like to welcome everyone to the first quarter 2019 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 and Investment Management of EPM Group, will be the host and speaker today. Mr. Tabares, you may begin your conference.

Jorge Tabares: Thank you and welcome everyone to our quarterly conference call for 1Q 2019 for the EPM group.

We are going to be using, as usual, the presentation that we have posted. The agenda topics are detailed on the second page.

Moving to the third page, three events are relevant to the quarter subsequent to the closing. The first one is that we actually executed a make-whole call for our 500 million USD bonds due in July 2019.

The second point is that we resumed our divestment process for the ISA shares. We adjusted the price upwards, based on the market movements of the share price after the closing of last year. Results were published and actually today is the final day in which those shares are going to be available for the special public as detailed in Law 226 in Colombia, so we will be disclosing how much shares we sold, probably in the next couple of weeks, although we do not expect that to be a material amount.

Yesterday, Wednesday, May 29, we actually closed successfully one of the two gates of the auxiliary diversion tunnel. This was the finalization of a long process of cleaning up the rails that the gate uses to go down and fixing the gate after one of the water hammer impact events during the contingency actually moved the gate out of the original place. This is a very important milestone as we closed the actual gate that was designed and it worked as expected.

Moving to page 4, all relevant markets in which we operate are actually showing significant growth over the first quarter of 2019: Colombia with 4.3% growth, Panama, 5.3%, and Guatemala similar to Colombia. Only El Salvador shows a small growth rate.

Our participation in the market was reduced slightly but remains at the same 23% level.

Actually, in terms of how much volume we sold, it went down by 6% and this is explained purely by the non-renewal of the contract that we had with Ecopetrol, with the Pacific Rubiales field. That contract by itself accounts for about 190 Gw/h for the quarter.

The rest of the operation is growing healthy, but we have that non-renewal of that contract that shows a relatively weaker performance compared to the market.

In the international operations, growth was more positive with a combined growth of 2.4 in the overall portfolio and the overall EPM group volume of energy sold reduced slightly, reaching a total of 6,425 Gw/h. That's a 0.9% reduction.

Moving to page 5, we have two important news. The spot prices went up significantly in most of the countries in which we operate. The combination of relatively dry hydrology and the rise in the oil prices supported the growth that we are showing in this page.

In Guatemala, the spot price for the quarter averaged 69 USD per Mw/h, with a 45% increase.

In Panama, rather similar to a 46.6% increase to 104 USD per Mw/h.

The biggest change was in Colombia, with a 77.7 increase and this is associated purely to the combination of market demand growing and most importantly, the hydrology.

We effectively have been based on the data in an El Niño situation for the last six months. Although it was a relatively mild El Niño, still can be characterized as such.

In terms of our power generation, again associated with the lack of rainfall, we basically remained flat. A slight decrease in our generation volume, reaching a total of 3,653 Gw/h of generation during the quarter.

The third point is on the bottom right, in which due to the dry season in the quarter in Panama, our generation from the Bonyic plant was more than half, and it reached only 16 Gw/h during the quarter.

Moving to page 6, just to highlight two elements of the macro scenario shown here. The first one is that the inflation conditions remain stable around the countries in which we operate. This is not the case in other countries in Latin America, but the ones in which we have operations are showing a relatively mild inflation variation.

GDP growth in Colombia reached 2.8, continued this upward trend, and we expect that at the end of the year is going to be between 3.2 and 3.5% in the most important countries in our operations.

Then I'll highlight also the reevaluation of the currencies across the board. Although this is March information, it is still showing the weakness of the currencies.

As most of you probably have noticed, the April information is more volatile and the reevaluation figures have increased significantly, as the dollar continued to strengthen during this last month.

Moving to page 7, our total Capex program for the quarter amounted to 539. I'm going to introduce a change in the way I post these numbers. I'm only going to name the actual figure. All of them are going to be in thousand million COP. Only as an exception, when it is not, I'm going to qualify what the unit is or the number that I'm going to be talking about.

Again, the Capex program was 539. The most significant one was the Ituango component, with 202, and about the same number invested in our water and distribution business in the EPM parent company. In the international subsidiaries, we invested 55, and we are about to finish the Aguas Claras wastewater treatment plant. In the quarter, we invested 26.

Moving to page 8, the financial results continue to be fairly positive. Continuing the trend of the performance during 2018, our Ebitda, while revenues grew by 12%, this is in the back of higher energy prices that I just mentioned, but also due to increases in tariffs in the water business associated with the important capital program we are putting in place for the water business in the Medellin metropolitan area, and the start of operation of the wastewater treatment plant.

We continue controlling costs and the Ebitda showed a 13% increase during the quarter, reaching a total of 1,452. There was a slight improvement in the Ebitda margin, reaching 34% and our operating margin was reduced slightly, and the net income reduced from 20 to 17. This is mainly due to higher financial expenses, which are associated with the strong cash position that we have built and some income tax provisions.

On page 9, we show the typical composition. This is a fairly standard view. No particular country is worth highlighting here. It's a basic trend that we have shown you during the last few quarters.

International revenues accounted for 34% of the total revenue, 16% of the Ebitda was contributed from the international operations.

By segments, on page 10, the power distribution business contributed to 61% of the total 4,285. Then, in terms of Ebitda, relatively similar contribution from power distribution and power generation. When we look at the net income, 48% of the net income came from the generation business and 37% from the power distribution business.

Notice that gas contributed to 2% of the total net income or the total Ebitda of the group.

Moving to page 11, the graph here shows here the typical growth rate in the Ebitda on the vertical axis and the Ebitda margin on the horizontal axis of the total combined margin of 34%, as I just mentioned, and a growth rate of 13%. The red line on the bottom in -20 should be on 13. Deca is the only operation that is not delivering growth. That is actually showing a decrease of 13% on the Ebitda and like last year, this is associated with a rate renewal process that we went through in Guatemala.

We expect to take some actions in the company to make it more efficient and regain the growth rate that we were showing in the past. The restructuring process in Deca is fairly advanced and we are very close to making the decisions that will allow us to regain the efficiency that we need, associated with the signal that the five-year renewal process, the signal received from the regulator.

Moving to page 12, we continue showing a very positive Ebitda growth rate. The CAGR in the last three years for the quarter is showing 6.9%, and most importantly, the bottom right graph shows that all businesses are contributing, gas, which I just pointed, represents 2% of the Ebitda, is showing a slight decrease, and this is associated with some seasonal operations that the gas business can typically execute, associated with trading. This decrease is not associated with the residential business.

Very solid growth rates from both generation and our water business. This is in the back of the important investment programs we are executing and also helped by the starting of the operation of the wastewater treatment plant in Medellin metropolitan area, which has a capacity of 5 cubic liters per second.

Moving to page 13, the asset base continues to show growth. It's growing at 3%. Equity is growing at 2% and our total liabilities stand at 31.641. This is a 4% increase, but notice at the bottom left that we have a cash position of 2.98 billion at the end of the quarter. This is a very ample cash position.

When we calculate the metrics for the leverage, our long term debt to Ebitda stands at 4. If we were to calculate it with net debt, that figure would move very close to the 3.5 target and stood at 3.51 at the end of the quarter.

On page 14, no significant changes in the debt profile in addition to the 500 million USD maturity that is not shown anymore, as we prepaid it, so we have a very low cash demand associated with our debt portfolio for the remaining of 2019.

Going to the Ituango project, on page 15, we are making progress in all work fronts in the project. We continue raising the dam. The current height level of the dam is 424 and we plan to reach the total design height for the dam, which is 434 meters above sea level, in the next two months, so we are making continuous progress and the monitoring of the dam and spillway block, that important contention element of the project, is showing complete stability in that front of the project.

We continue assessing damages of the cavern complexes and the tunnels of the project. We have already fixed some of the damages that we have found but we will have a much clearer view of the total damages and the cost that will be required to fix them at some point at the end of 3Q or early 4Q.

We are observing complete stability across the project. All the monitoring and all the activities that are being conducted underground are for the most part being executed without problems.

On page 16, we have some of the dates of the expected fixing of the different elements of the project. Very important in terms of the auxiliary deviation gallery is the closing of the gate that we executed yesterday, and we are planning to close the second gate at some point in 3Q.

After those gates are closed, as originally planned, we will put a final plug and that construction will take us all the way to 1Q 2020, but we highlight the fact that the gates are closed allowed us to access those tunnels to actually do the plugging work as the gate provides safe conditions, not only to work on the tunnel but to the communities downstream of the project.

What is going to take us longer is the closing of the right deviation tunnel. We are expecting it will take a full year, although we have observed very stable conditions for more than 8 months in the infiltration water that is passing to the right tunnel. We are pursuing very actively the engineering closing of such tunnel but the operation is relatively complex and will take time to execute.

On the right-hand side of page 16, you see the different elements of the powerhouse. It's about without water and we are going to be extracting and removing all the sediments that accumulated that in some parts of the cavern are quite significant.

These are sediments that came to the tunnel that at some point collapsed, mainly number 7 and 8, which as some of you may remember, closed unexpectedly at some point in May last year.

Perhaps the other point to highlight is the access tunnel to the powerhouse. We are progressing very significantly in the stabilization of that tunnel and after we do that, we will do further engineering work to make it available for all the equipment that we need to use in order to do all the works in the cavern complexes.

While we fix this tunnel, we are facilitating access through the three discharge tunnels. None of the three discharge tunnels that were used to evacuate water during the contingency, while the water was passing to the powerhouse, so for any damage, the three tunnels are available and are just being adapted in terms of rough surface to allow entrance into the project.

We maintain our original estimates, although we have much more information now, that phase 1 is going to enter into operation in December of 2021. At that point, we expect to have two power units in operation and the other two to complete phase one are expected to enter in 2022.

In terms of the additional cost, the numbers do not change from the ones that we have shown you in the past. We are estimating 15.3 billion COP. Since the contingency, we have invested a total of 699 and from that figure, 83 correspond to expenses which, as you can see, represent still a low fraction of the total figure that we have up to March.

The net income incorporates a total of 491, from which we have actually spent and paid 83.

On page 18, we provide a breakdown of the main sources of extra capital costs of the project. Notice we are expecting a 33% increase in the total cost of the project compared to the original budget, and the two key contributing factors are the infrastructure and main works, which we now expect to cost us 7.3 billion COP, a 38% increase, and equipment, with 2.1 billion COP, with a 41% increase over the original budget.

The portion of the capitalized interests that are shown as increased, I note that do not represent extra cash for us, because we would have been paying those interests anyway if the project were completed and operational. That cash flow was going to go to interest expense since the project is not operating yet. We need to capitalize those so they add to the total cost of the project but do not represent extra cash flow for the company's needs.

On page 19, we continue monitoring very carefully all the cost reduction measures that we put in place and are delivering on those and in fact during 2018 we overpassed the original goal, which was at the EPM parent company, close to 200 and we delivered 240.

The contribution to the expenses comes from all the operations, as the mandate from management was that everybody needed to contribute.

Moving to page 20, an update on the insurance. For civil liability, we got confirmation of coverage and we actually got the first payment of 2 million USD during May. It's not within the reporting period, but it's relevant enough to mention it.

In terms of the [unintelligible] policy, we continue the process of demonstrating occurrence on the amount of the loss and are working very diligently in full cooperation with the reinsurance companies and the adjuster's team to try to come with a resolution of coverage as soon as possible.

Page 22, the divestment process of the three assets is moving forward. As mentioned, today is the last day for the initial stage one process for the ISA shares and from that point, we will structure stage two of the sale process and our expected closing by year-end.

In Adasa, we launched a transaction last week and we expect to receive non-binding offers by early 3Q. In Cururos is the most advanced process. We are pending to receive in a week the non-binding offers, and given the simplicity of that asset, we expect to move forward to a binding offer very soon afterward. We're expecting to close at some point between late 3Q and early 4Q. All processes are moving ahead.

On page 23, basically, the only change here is the Ituango investment from the last figures that we have shown you. These are the only figures in the presentation that are shown in USD to facilitate understanding. A total of 3.5 billion USD of investments in the '19-'22 period, fairly well distributed between the EPM parent company, the subsidiaries, and the international businesses.

Ituango with the updated numbers now represents 34% of that capital program. In addition to the cash position that we have currently at hand, which at the end of March was 2.98 billion COP, slightly less than 1 billion 800 USD, we have a total of 771 million USD of facilities signed and available to be disbursed, so our liquidity position is fairly ample.

With that, I finish, so I'll highlight financial performance has been very good. We continue making technical progress and investing in Ituango and are firming up the total costs and schedule to finalize the project and have a very ample cash position at this point in time.

With that, I'll open it for questions.

Operator: At this time, I would like to remind everyone, in order to ask a question, simply press * and 1 on your telephone keypad. If you would like to withdraw your question, please press the # key.

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

We are going to reply questions first from the audio conference and then questions from the web.

At this time, we have no questions from the audio. We have a question from the web. "How much do you expect contracts for this year?"

Jorge Tabares: This is going to be a big year for the Ituango investment. We expect to invest 1.5 billion COP in the project during 2019. As shown before, from that figure, we have reinvested in the first quarter a total of 200.000 million COP.

Operator: At this time, we have no further web questions. Mr. Tabares, do you have any closing remarks?

Jorge Tabares: I appreciate the participation. As always, we continue to be available to resolve any possible questions via our investor relations connection. Thank you very much.

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