Q3 2015 Empresas Publicas de Medellin ESP Earnings Call
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Corporate Speakers

- Jorge Andres Tabares Empresas Publicas EVP Corporate Finance and Investment Management

PRESENTATION

Operator^ Welcome to the third quarter 2015 EPM Earnings Conference Call. My name is Hilda, and I will be your operator for today's call.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session.

Please note that this conference is being recorded.

The host and speaker will be Mr. Jorge Andres Tabares, Executive Vice President of Corporate Finance and Investment Management of EPM Group.

Before I leave you with your host, let me remind you to take a look at the disclaimer of today's presentation. Now, I will give the floor to Mr. Tabares.

Jorge Andres Tabares^ Good morning and thank you for connecting to our quarterly call.

Let's move to page 4. We mention about the relevant facts during the third quarter of 2015.

On the financial side, we highlight the first loan agreement in Chilean pesos signed in August by [Corvina], EPM's investment [inco] in Chile for the equivalent of $400 million. This operation is part of the financing of the acquisition of the shares of Aguas de Antofagasta, and confirms a new source of funding for the Group.

The second relevant fact is authorization by the financial superintendent in Colombia to increase the amount of EPM domestic bond program to CLP4.5 billion, from which we have used CLP2 billion so far.

Lastly, due to el Nino phenomenon and to the variations in microeconomic factors, an increase in revenue in costs of EPM's commercial operations were seen. For that reason, the board of directors approved a budget of EPM for the remaining of 2015 for CLP309,000 billion cut in revenues and CLP301 billion cut in costs.

We will detail later the weather situation.

Regarding operations, we highlight that the board of directors authorized the management to carry on endeavors necessary to merge Aguas de Uraba and Regionale de Occidente, both EPM water subsidiaries. The merger will permit new (inaudible) and operational synergies as well as an acceleration of investment plans that will result in improving quality, coverage and continuity of water services offered by EPM Group in [Antiocios] western and in (inaudible) region.

[With having] corporate governance, the board of directors approved amendment to its internal ruling and to its committee's ruling in order to include different corporate governance practices, specifically those of [Covigo Paiz], is an initiative promoted by the financial superintendent independency that gathers recommendations from the best corporate governance practices for issuers in the industrial and financial sectors.

That way, we are helping best corporate practices that create transparency and efficiency and which, in turn, promote development of the capital market.

As to the water situation which the country is going through and which has intensified in the last couple of months, I will provide some details about the case and its impact on EPM's power generation in the next few pages.

On page 5, you can see the comparison between el Niño reoccurring conditions and the strongest event of history since the 1997-98. The [opter panel] show the normal ocean surface temperature. And the red color is the positive anomaly. That means above the normal temperatures. The [menu] is divided into four regions of the Pacific Ocean. And the most correlated with the Colombian hydrology region is 3.4. This is between 120 and 165 west longitude.

In this region during 1997, temperature was 2.55 degrees, while in the past four months it was 2.46 degrees above the normal temperatures.

The bottom panel shows subsurface temperature departures in the Equatorial Pacific. The red area shows the content of stored heat in the deep ocean, which is gradually emerging. As you can see, the stored heat is now more spread than the 1997 event.

We have now 100% probability that the phenomenon will continue during February, March and April, and 75% that it will go in the quarter April, May and June.

Moving to page 6. Now we see the impact of el Niño on the Colombian hydrology.

The top chart shows the performance of hydrology of EPM and the national system, SIN, as a percentage of the historical average, which are the dark dotted lines. During 2015, [affluence] of EPM reservoirs have been 70% of historical average, and 85% for the national system.

From August, the deficit has become more evident tending to the behavior of [serbi] observed in 1997-98, which is the red line.

Referring to EPM reservoirs, the bottom graph shows the typical evolution of EPM's aggregated reservoir storage capacity, compared with 2015 evolution. In Colombia, the [winter] into rain that occurred from May to November. [Time being] which the reservoirs must be filled, moving from 35% to 80% of its capacity. Summer, which is the dry season starting in December and runs to April.

In March of this year, the key weather agencies began to indicate the arrival of el Niño. So, EPM began to take care of the reservoirs, trying to keep them above their typical levels, as you can see on the bottom chart. We have a target level of 70% for the end of November, and we are on track to achieve that, being at 67% now.

On the bottom chart we use less of our reservoir during March, April, May. This is at the caution of the announced el Niño phenomenon. And that is what allows us to have a higher storage capacity than if we were to have followed the regular path of using the reservoirs and then filling them up in the second part of the year.

On page 7 shows three forecast scenarios developed by the [hudme] to the mining and energy planning unit on how they compared to us for the month. The red line, which is the actual. [When] the el Nino occurs, the electricity consumption increases by the greater use of air conditioning and fans and more needs for pumping water. Or when we have less rain, we also have more energy demand.

For that reason, the government initiated energy-savings campaigns and is considering measures to [pond the waste] the consumption [above] certain other [ishe].

Next page. We observe the spot price. The left axis are the quantities of [gigawatt] hours per day. And the right axis are the prices in Colombian pesos per kilowatt hour. This spot price had been around CLP200 up to August before the starting of the actual critical conditions.

And then, to September 22nd, the spot price is exceeding the scarcity price, which is a regulated price at which we activate the [full] energy obligations of the plans that have been [exceeding] the liability chart.

You can see our strategy of storing water in reservoirs and with saving gas we generate to our thermal plant helped to cover the full energy obligations and contracts in the start of the critical condition.

The spot price has risen, which is not shown there in the graph, for the last five days. It is starting to moderate a little bit. And it's now at the 600 level.

On page 9, in Colombia, the reliability chart is the mechanism that ensures the power supply when el Niño conditions occur. The regulator, the [CRED], assigns firm energy obligations, [OES] to existing or new plants through [options]. And if the existing supply is greater than demand, the [CRED] assigns obligations proportionally.

When the spot price is lower than the scarcity price, agents only trade energy by contract. And its top transactions all [EF] are not activated. When the spot price is greater than the scarcity price, additional to conventional transactions, foreign contracts, the generators are required to produce their obligations. A thermal plant must produce obligations even if the scarcity price is not recovered, but that's not allowed to recover variable costs.

For example, our thermal plant, la Sierra, generates with gas or diesel. The variable cost of generating with diesel is DLP570 per kilowatt hour, while the current [cashebee] price is DLP302. Or when you generate with diesel, you lose the difference.

The [money] never sees price - our scarcity prices. Our prices higher than scarcity price only apply between generators.

We move to page 10. We have taken several actions year-to-date that impact on our energy needs and our financial statement due to the el Nino phenomenon, which will bind us both short term and [interruptible] in order to operate half of the la Sierra plant. And that started on May 10, 2015.

As I showed you before, we have used the reservoir capacity in a responsible way so that we can reach the threshold that we want and need to continue produce throughout the el Nino season. We have carried out investments to guarantee a liquid fuel supply and logistics for terminal plants so we can move them as we need them.

We have acquired gas from a [corpit toll] for a full year starting on November 15. And that will allow us the partial operation of la Sierra and [Dorada], which is another terminal plant in our portfolio.

Given the sustained condition, we are going to incorporate [Terminoran Caplan], which is a 48-megawatt plant owned by [H El], our subsidiary. And we are starting to bring that plant up in January 2016.

We have worked along with the Ministry of Mines and Energy under the [DFA] body in order to define a stop price that is capped and a scarcity price that is adjusted to historical levels and that will reflect the cost of generating with either gas or liquid.

In order to mitigate the impact on clients and users, as I mentioned, they are not impacted by the spot price but only by the scarcity price. A tariff option will be adopted which means that with the sale over time increasing gradually the price of energy today throughout the season. Those prices will then come down as the weather situation and reservoir situation normalizes.

Moving to page 11, during the summer, we have seen that the el Nino phenomenon will impact our generation business for the projected - and the EBITDA impact of the fourth quarter of 2015 and first semester of 2016 is an amount between CLP500 billion and CLP750 billion, or less than $300 million, $350 million in the worst case.

[Such things] have been explained by lower hydrology generation and the thermal generation with gas and liquid fuel.

Importantly, despite this impact, EPM's [spellingnine] projected earnings for 2015 is CLP1.5 billion, which is very close that of 2014 which is our best year ever.

Those good results are possible thanks to first, it's the continuation of the transformation process looking for efficiency with actual costs lower than budget in an amount close to CLP200 billion in 2015. And also benefits from the portfolio diversification, we have increased revenues not affected by el Nino due to geography of different business units. And also by the recently declared dividends from UNE, which is our telecommunications company in Colombia in association with [Millicom].

Adding to the efforts to nationalize cost and expenses and additional benefits of revenue diversification, or ADASA, our water distribution company in Chile sent out, our preliminary projection for earnings in 2016 is similar to that of 2015.

Moving to page 12, I'll just highlight a few points here. Colombian energy demand between January and September totaled 49,000 gigawatt hour with a 3.8% growth over the same period of last year. The growth rate is above the historical average of 3%. And it has been most dynamic in the residential sector reached mid-year with rates above 7%, highly correlated with the higher temperatures brought by el Nino.

Over the unregulated demand, those [strength is duff] due to deceleration of the Colombian economy, close to 1% deceleration. This is mainly due to the falling revenues and investments from the mining and energy sectors and the devaluation of the peso on increased inflation.

On the left, it is expected that due to the el Nino phenomenon, electricity consumption in the country will continue growing in what is left of 2015 and the first quarter of 2016.

In this sense, the main drop of regulated and non-regulated markets close to 4% is expected toward the end of 2015, with some deceleration of consumption during next year due to the economic situation.

I'll highlight that and the fact that across Central America, the businesses are growing and the valuations are not [relatively] and are not material in our portfolio. But, in general, we are in growing markets.

The [has] Guatemala which has a lot of uncertainties in the political panorama, that is showing signals of economic strength. [Relative green] in September and economic activity has increased since July, supported by financial service and manufacturing.

We expect that electricity demand will continue on a positive growth path. And the growth rate from January to October rose 5.4%, which is higher than the 3.6% average of the last five years.

The aggregated commercial demand of EPM within Colombia was up [0.2%] in the first nine months, basically due to the arrival of the new customers that were served by our trader, as we have previously mentioned.

The negative growth rate of some subsidiaries in Colombian [extended] by such transfer. And that fact is shown by the 7.3% growth in EPM's commercial demand.

The [isolate] does affect the higher demand drop of EDEQ and CHEC through our subsidiaries [preferred] to be highlighted. They are growing at rates higher than 4%, resulting mainly from a coffee boom in the regions.

Lastly, we note that EPM Group in Colombia retains its 24% participation in the electricity energy trading activities. Internationally, on the distribution side, the Company of EPM [vee in] 5% DELSUR in El Salvador and [ENSA] in Panama, which had the largest growth rates in the period under analysis.

EEGSA in Guatemala had positive growth rates, although lower than the country's total. This is explained because this company covers urban areas where utilities coverage has reached comparatively higher levels.

Moving to page 13. I already mentioned about the electricity prices in Colombia. The number in the block is also impacted by the depreciation of the peso. So if we work the [isolate], the exchange rate effect given the high devaluation of the Colombian peso versus the U.S. dollar, the valuation of the average spot price for the first nine months of 2016, relative to the same period of a year ago, is only 6%.

In Guatemala, the prices are impacted by excess supply in the power sector. There was a 110 megawatt, [which was] a new hydro plant that has started operation in August 2014, and a [255] megawatt [coal fire] plant, [Jaguar], which was commissioned recently.

Because of this and also because of the climbing fuel prices between January and September of 2015, the spot prices were lower than those of the same period last year.

The power system in El Salvador depends, to a large extent, on thermal generation. And, as a consequence, the drop in international oil prices caused a highly significant decrease in spot prices of 28%.

[Day] levels have also decreased in Panama as a consequence of El Nino. However, prices have been below $100 per megawatt hour due to the entrance of the new hydraulic wind and solar products, and to the international price decline for coal and oil derivatives.

In Chile, at [Baquedano], to which EPM's Group plants belong, there is a decline in the spot price due to the effect of el Nino phenomenon, which in this country means higher water inflows into the southern reservoirs. Additionally, ice melting has been higher than expected meaning increased availability of hydraulic energy in the system.

Moreover, widespread renewal technologies such as wind and solar and the low price of fuel have kept electricity price low.

Generation of EPM Group in Colombia. The recent months of 2015, water flows mostly [is] the EPM system were below historical needs, as we explained.

Internationally, I would to highlight the commissioning of the [van gee] hydro plant in Panama which generated 56 gigawatt hours in the first three-quarters of the year. And the [Los Coruros Wind] plant in Chile, which has produced [162].

Moving to the next page of main projects. Here we have the [Ituango] hydro plant with a [dissatisfactory] the progress of 35%. The main works of the project - we have 79% progress in excavations for the power house; 59% in the spillway; and [bon fields] are at 21%.

An important milestone achieved in October is the connection of the roads where for [Valdivia] dam site that permits transit of machinery and technical personnel between the two work fronts, and will expedite remaining works.

The road built by the [Ituango] [highway] project becomes an alternative way that will permit communication for the inheritance of neighboring rural areas and becomes a vital contribution to the future development of the transport system in the [tilt en] north and lower [Calca] regions. This road also provides our most efficient way to enter the main equipment to the project.

Year-to-date, the [Ituango] project investment totals $411 million, and the total accumulated investment is $1.8 billion. In general, the project advances according to budget and schedule.

Moving to the Aguas Claras Park, a waste water plant in Brazil, is our major [project] water business. It’s 55% of [val]. The project of civil works is 4%, and the mechanical component is 64%, and the electrical component 26%.

The construction of the interceptor of the waste water main tunnel is advanced almost totally, 98% of the 7.5 kilometers. And the construction of its intersection is 100% completed.

Year-to-date, the project investment is [$86] million, and the accumulated investment is $234 million.

Moving to macroeconomic scenario on page 15, the economy of the region for EPM [sprelling] were less dynamic than expected, and the growth rates have been revised downwards; but still quite positive. The largest decreases are in Colombia, Mexico and Chile.

The main reasons we can name the price drop of commodities and fuels added to the volatility of the exchange rate. The heavy inflation only in Colombia was 4.76 and Chile was 3.97. That had inflationary pressure resulting from the price of feed stocks and the effects of the peso devaluation on the imported component.

Colombia shows a rising trend for the third quarter of the year resulting from higher impact of el Nino phenomenon.

In Mexico, for the second quarter inflation, there was a 0.65% inflation in the third quarter.

Other countries remain within expectations and close to the goal range, except for El Salvador that shows deflation.

Regarding the foreign exchange market, the currencies of the countries under analysis continue to devaluate. Columbia was the highest percentage followed by Chile and Mexico, and again caused by the drop in oil prices and copper prices, the decline of foreign direct investments and the increase in current account deficits.

Moving to page 16, financial results. The Group produced the following financial results - $9.9 billion of consolidated revenue, growing 14% in respect to the same period last year. The EBITDA stood up at CLP3 billion, with a 14% variation and an EBITDA margin of [31%].

The comprehensive income for the period totaled CLP926 billion, with a 9% margin and a 59% decline that I will explain in a minute.

Included in revenue and EBITDA was the improved operational performance of the Group's different business units.

The comprehensive income for the period decreases with respect to last year mainly because of the extraordinary revenue in the [in American] transaction and building costs, which was paid directly to the municipality of Medellin.

The CLP578 billion exchange rate expense resulting from higher exposure of debt [higher] by the Group, and the increased interest expense of CLP339 billion due to the new bond issued locally early this year and additional loan disbursements.

The amount of [theme] margins - only net margins have significant variations, 16% has [pointed] down, mainly because of exchange rate losses.

Page 17, our power business unit accounts for 86% of the revenue and EBITDA 76% of the Group's comprehensive income for the period. Most of our businesses are growing.

I'll jump to water business unit, which revenue and EBITDA represent 9% and 13%, respectively, with CLP165 billion [drop].

Here we highlight the revenues of the new subsidiary Aguas de Antofagasta, CLP418 billion. This acquisition took place in June.

The higher revenues from the Group [of fixa], the subsidiary in Mexico, for CLP61 billion, mainly due to the higher exchange rate, has contribution to the consolidated figures. And increasing EBITDA parent company of [CLP21,000 billion] due to larger number of users, average revenue and consumption.

Note that water provision segment represents 5% of the consolidated EBITDA; excluding ADASA, it will represent 3%.

The period's comprehensive income was affected by the exchange rate difference, expanding the power and water business and due to increased debt exposure and the inclusion of debt of the investment vehicle used for the acquisition of [da ra].

Next, to the Group results by country. Of the consolidated revenues, EPM parent company contributed 47%, equivalent to 13% increase on the same period a year ago.

International subsidiaries grew 36%, equivalent to 20% increase on the same period in 2014.

On the Colombian power subsidiaries, 52%, a 6% increase from last year. The remaining 2% corresponds to water business units.

Let's highlight the diversification of our portfolio. With respect to the Group's EBITDA, EPM parent company accounted for 63%, with 13% increase. International subsidiaries were 22%, increasing 89%. And the Colombian power subsidiaries accounted for 14%.

The revenue of the comprehensive income for the period, the parent company accounts for 76%, equivalent to a 74% drop for the same reason explained before. Colombian power subsidiaries accounted for 20%, with a 23% increase. And international subsidiaries accounted for 4%, a [69%] decline.

Here, we call attention to [South Water], a subsidiary of EPM in Chile, with net expenditures of CLP298 billion, resulting from that updating of the exchange rate loss of the $791 million loan and other adjustments related to that investment.

You can see altogether the subsidiaries of EPM Group maintain their outstanding performance. In particular, we highlight the contribution to revenue by international subsidiaries such as ADASSA, already mentioned. ENSA in Panama, [DECA] in Guatemala, and DELSUR in El Salvador, with CLP187 billion, increased due to tight adjustments from the normal five-year revision and more power [sol], 94 gigawatts hour [nexa]. And the electrical [turry] in Panama with revenue for CLP32,000 million.

The results of EPM's foreign company have been very positive despite adverse conditions of the year related to issues external to the Company such as the high devaluation of the peso versus the U.S. dollar almost 31%. Up to September, the negative effect of tax law, which is why the additional CLP78 billion [in the same] due to the wealth tax and the low rain levels resulting from el Nino with the ensuing drop in reservoir levels and lower hydraulic energy generation.

Let's move to page 19. Here we have the total assets accounted to CLP41 billion, increasing 13% for the [hydro] investment for the purchase of ADASA and the projects of Ituango power plant and the waste water treatment plant [stand out].

The Group's liabilities totaled $22 billion with a 19% increased, produced, as I said, from the domestic bond issue and the consolidation of ADASA debt.

The equity total is CLP18.6 billion, growing 7%.

In the financial ratios we highlight the Group's total debt to total assets which amounted to 53%, one percentage point above 2014. Financial debt to total assets was up 32%. The debt coverage [ratio] for the quarter and EBITDA to financial expenses of 6.49 times and debt to EBITDA of 3.31. The growth debt to EBITDA rate [is out of] including especially loans we had 3.48 times.

Leaping to page 20, our total debt totaled CLP14 billion. And that 27% corresponds to domestic debt, 16% to pesos denominated foreign debt, and 57% to foreign debt [higher] other currencies.

EPM Group's total debt, 73% belongs to EPM parent company. And that is our [bias] of financing the Company, the Group.

Regarding hedges, we currently have CLP194 million of [volunteer] hedging and CLP329 of [natural] hedging with inter-company loans granted to subsidiaries that have revenues linked to the U.S. dollar.

We continue implementing our hedging strategy, including the use of financial derivatives, management of U.S. denominated cash flow [plosses], and conversion into pesos of loans denominated in dollars.

[Avoided] the combination of all those measures [avoided] by September 2015 and increased the negative affect in the net income statement of CLP315 billion. That [inhap] expense from exchange rate losses.

As to maturities, we hold international issues maturing in 2019, 2021 and 2024. We continuously analyze those to see if there is window to roll over those. And in that way, adjusting for the needs of the Company to comply with our strategic objectives.

Finally, some important events [subsect] the [sticking] to our closing. The first one is that we start sharing with you the news about the dividends to shareholders [the club by ene]. Our share is CLP233 billion, which is very good news because it reflects a good - captures the good health of that business and the balance of the one year of the merger that is delivering operational results and the synergies.

More good news is that - many of you may not have heard - in our annual review of ratings, both Fitch and Moody's ratified our ratings. The most positive part are the five positions advanced by EPM [gloning] the rankings of 100 [ETLatin] companies released by America Economia Magazine. We are now 65 in that ranking.

And [Merico], which is a Colombian [highly representative] study, and an [instrument] that measures the reputation of companies since 2008, include one position and are now number four among the companies with the higher reputation in Colombia in the last four years. In the last four years, we have taken the first five places of the [Merico] ranking. Again, as one of the most prestigious organizations in the country.

Lastly, the board of directors approved a new budget addition for [2015] as a consequence of el Nino phenomenon. We have a CLP307 billion of additional revenues due to commercial operations, and associated costs of CLP885 billion.
This negative impact is already included in the comprehensive income for the period that we estimate for 2015 and mentioned above. This is the CLP1.5 billion of estimated comprehensive income for the period.

With that, I conclude our presentation. We'll be happy to take questions from the audience.

QUESTIONS AND ANSWERS

Operator^ Thank you. We will now begin the question-and-answer session.

(Operator instructions)

Jorge Andres Tabares^ While any questions could arrive, we remain open to receive subsequent questions through the regular channels, the website or to [Catalina]. Very happy to answer any further questions.

Operator^ (Operator instructions)

Thank you very much. Ladies and gentlemen, with this we conclude today's conference. We'd like to thank you for participating. You may now disconnect.

Jorge Andres Tabares^ Thank you.