Transcript – 3Q2019 EPM Group Financial Results Conference Call

Operator: Good afternoon. My name is Hilda and I will be your conference operator for today. At this time, I would like to welcome everyone to the third quarter 2019 consolidated financial results conference call for 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 Investments of EPM Group, will be the host and speaker today. Mr. Tabares, you may begin your conference.

Jorge Tabares: Thank you operator and welcome everyone to our 3Q 2019 report.

As usual, we have published the presentation that we are going to follow through. In the agenda, five items. We'll talk about the relevant events recently for the company, the energy market in the countries in which we operate, our financial results as of September, an update on the Ituango project, and also an update on our divestment plan.

Moving to page three, the relevant events of the quarter and subsequent to the closing, the most important as published at that time is that on September 16th, we received confirmation of coverage from the Mapfre insurance company regarding the construction policy for the Ituango project. That's a very important milestone and we continue evolving in the resolution of that claim, as I'll explain later.

On September 17th, we agreed on a transaction to sell our wind park in Chile for US 138 million to AES Gener. We're working towards the closing of that transaction in the next few days.

Finally, on October 30th, Fitch ratified EPM's international and local ratings, AAA local, BBB international respectively. The outlook did not change in this annual review from Fitch.

On page four, in the last couple of months our Board of Directors approved the disposal of some small stakes we had in two companies called Promioriente and Hidroeléctrica del Río Aures.

Our domestic bondholders had to authorize the merger of EP RÍO and EPM. This is a company that provides the water service in the Rionegro area close to the international airport, which now with the new road that was put into operation is about 25 minutes from EPM's headquarters, so it's a territory that is close by. This merger is not material from the financial perspective. EPM RÍO accounts for about 0.2% of the EPM operation from the different metrics that you can look at.

Finally, we improved and updated our governance structure or the group's governance codes, adopting basically evolving practices and improving those documents. This is an update that we do every few years to keep it up to the evolution of the international standards.

Moving to page five, one of the things that I will highlight in this conference call is the significant and positive growth of the electricity demand in Colombia. The country through the 3Q of '19 grew at 4.15% with very solid growth and we participated with 12,168 GWh during this period of time, contributing to 23% of Colombia's electricity demand.

Healthy growth rates also in Guatemala and Panama with 3.26 and 4.65% respectively. When we look at the total energy sold by the group, in Colombia that figure accounted for the number I just mentioned of 12,196, and that is 4% lower than the 2018 number, and that's basically because of one big client associated with the Rubiales field was lost. That's not had a corresponding impact on the margins, as this big contract has not delivered the typical margin that we have at the group level.

Looking at the international operations, the growth rate was 2.6%. The biggest growth in ENSA, in Panama, with 3.5% over the nine months, and EEGSA in Guatemala, with 2% growth over this time frame.

On a compounded basis, the total energy sold was 1.6 lower than the previous year, again, with not a corresponding impact on our margins and profits.

Going to page six, the energy market, highlighting that spot prices in Colombia, where we have the biggest operation, do not have a significant impact, as most of the energy we have sold in advance. Nevertheless, the variation in Colombia is fairly positive, with a 72% increase in spot prices, reaching US 65 per MWh. This is due to the combination of a lower hydrology plus the strong demand that I mentioned earlier.

The spot price also grew significantly in Guatemala and Panama, mostly associated with the hydrocarbon markets.

In terms of the total generation, we generated 11,635 GWh during the nine months, and that's a 0.4% increase over the same period in 2018.

Our Cururos production remained flat, and our Panamanian production had a significant reduction of 33%. This is associated with lower hydrology in an asset that has very little water accumulating capacity so it's basically a flow through all the rain flow.

Moving to page seven, on the macro scenario, I'll highlight that on the CPI there are moderate results across the board in the context in which we operate. Things are working under stable conditions. Perhaps highlighting on the Colombian side the PPI, the 4.55% on a cumulative 12-month period is high compared to the recent numbers over the last three or four years. This is positive for the company, as the distribution of electricity prices are linked to the PPI, so this is going to improve results and in part is associated also with the hydrocarbon markets.

The PPI was lower than the CPI for a few years in Colombia, basically not showing the same correlation that it was showing in the previous years so to some extent the PPI in Colombia is catching up from the statistical perspective.

In terms of exchange rate variation, Colombia is showing the highest devaluation of the currency with 6.53% at this point in time as to highlight that since then, the peso has appreciated significantly and is now a 100 pesos per dollar below what it was here at this showing. It went down but it is now reaching about the same level of where it is now, 6.5% depreciation for the period. The Chile 4.31 depreciation that is shown here has changed in the last recent events over the last few weeks in Chile.

On page eight, our story remains a significant Capex program. It is fairly diversified. Ituango represents 33% of the total Capex program with a 2.1 billion pesos to date and 703 of those are in our water and distribution businesses in the parent company mainly serving in the metropolitan area of Medellin and Antioquia state, and 17% of that equivalent to 343 relates to the international operations with Chile and Guatemala getting the bulk of that amount.

In total, 70% of our Capex program is associated with the power business and the remaining 30% associated with the water business.

Moving to page nine, as of financial results, we published the quarterly results but I am going to focus on the nine-month period ending in September. Solid growth across the board, with 11% in revenues. A 15% growth on our Ebitda, and I'll highlight that this is organic growth, in addition to increased revenues associated with more clients, tariff increases that reflect the heavy Capex program, and higher demand because of the Colombian economy mainly doing very well. It also contributes to a higher Ebitda.

Our cost and efficiency programs. We keep very focused on saving money and being very careful in our Opex prorgams so we continue contributing to our Ebitda.

On the margins in the bottom right, I'll highlight the Ebitda margin, a 33.9%, this is the highest one at these four years, again, reflecting a very solid performance from our operational base.

We publish here the typical breakdowns of revenues by geography and by segment. The only point worth mentioning here from page ten is the contribution from the international operations, which is higher of what is has been in the recent quarters, with 36% of the revenue coming from the international operations, and that represents at this part 21% of our Ebitda.

Moving to page 12, we see most of our businesses are contributing to the growth in our Ebitda. I'll focus on the three assets that are not growing the Ebitda: in Guatemala, DECA. We're still adjusting to the new tariff renewal period, which was last year, and which is targeting the results here in the next few months and getting back to positive numbers on DECA.

In TICSA, this is lower growth, also not very meaningful at the group level, and then ADASA is reflecting two non-recurrent events that occurred in the north of Chile early in the year. One was more difficult to treat water coming to the desalinization plant. This is a phenomenon that occurs every four or five years and happened to be quite strong this year, and that means less water production, more expenses to produce that desalinization water.

And also a stronger than average rainfall period in the desert, in the Atacama desert, that, again, limits our water production, and also the [inaudible] in additional expenditure to clean up the damages caused by the rainfall and the accumulation of that rainfall throughout the desert until the point in which we actually – accumulate or take the water to distribute.

Moving to page 13, I'll focus on the bottom right chart. Very healthy growth by our three main businesses, generation, distribution, and water, reflecting that everybody is contributing to our growth here, which is showing an 11% because it relates to the last 12 months, which compares to the 15% of the nine months up to September so the growth is associated with all the businesses.

On page 14, again, the capital program is reflected here in an asset base growing at 6%, reaching COP 55 billion. You see a 6.7% growth over the last four years and a key metric that we track here is the Ebitda. Our last figures were trending towards the 3.5 target. On a gross basis, the long term debt to Ebitda is 3.8 and if we include the cash position that at the end of September was COP 2.5 billion, that's about USD 700 million, that figure goes down to 3.35, as pointed in the chart in the bottom right.

On page 15, not many changes since the last quarter report, as we have not done any operation in the capital markets or in the banking system. Just to highlight that combined with the cash position that I mentioned in the previous page of 2.54, we pretty much have covered the maturities of '19, the remaining '19 and 2020, and on top of the cash position, we have committed credit lines for USD 715 million approximately that could be disbursed.

Based on our current capital program and the cash position, we expect not to have to withdraw money from the credit line on any significant manner over the next year.

On page 16, an update on the Ituango project, which is our most significant one. Although we are still having technical challenges in some areas of the project and are still working in the design and crafting the engineering solutions for some of the areas, we have seen significant stability across the project. On the dam, we basically finalized the superficial activities and put the road that goes across the dam into operation last week on November 8 so the vehicles that are going to Ituango can pass by the tunnels in the complex and then use the top of the reservoir, which is a safer and faster way to get to Ituango now.

And then the current view of all the technical accident is explained on page 17. The work fronts are basically the same that we have talked about in the past. I'll just highlight two points here. One is the conduction tunnels. We are still working on closing the right tunnel, which is referred to as RDT here. We developed a fairly innovative solution. Although we have done this in a smaller scale previously in one of our projects, we're doing it at a major scale here at Ituango and we have gone very far in the design, as far as a scale model in the University of Utah in the United States, that confirms that our design parameters and assumptions are going to work and we fine-tuned that solution. We have drilled the holes to actually implement the solution and the spheres that we are going to put into the system are being manufactured and over the first half of 2019 we should be implementing that solution.

On the ADG, we are within days of working the right gate, and that will help us totally close that tunnel to be able to enter it and put the definitive plug, but I'll highlight that the temporary plug is enough to provide total safety for many, many months.

On the intake tunnels or conduction tunnels, we have put the structure in place and are about to start the concrete filling of the cavity identified between tunnels 1 and 2 and this is something that will be finished in the next quarter, the first Q of 2020.

Across the powerhouse and the cavern complex, we have been fixing the weak areas that we have found. We made a decision to actually fill the intake, the powerhouse, and the source tank, to be able to reach the ceiling of the cavern to test it meter by meter, and ensure that there are safe conditions for people working in those structures, and we are about to start lowering that new filling as we fix the walls in the damaged areas that we have found, implementing a solution that is relatively simple to stabilize for the long term, for them to proceed with the installation of equipment.

Our current view of the schedule is not changed. We are expecting to put the facility into operation in December of 2021, about two years from now.

In terms of costs, two elements of it. One is the total project cost. We have not changed the estimate at COP 15.2 billion. I'll flag that we are seeing some changes and some further details of some of the engineering solution that could point to a higher cost of the project. We cannot disclose it at the time because the numbers are not firm so engineers are working on it, but what I am foreseeing is that the 15.2 could further increase, as the engineering plans mature.

In terms of actual payments, during this year they only account for COP 113,000 million. That's about USD 30 million during the first nine months and that figure is about 20% from the total accrued amount that we expect to be paying here over the next few years. The payments are not coming as fast as we expected, which is positive, I should say.

In terms of insurance, I'll jump to page 20, which is the most significant one, which is the construction policy. I'll say three things. One is the confirmation letter. It's a firm letter. The companies are working towards paying us. We are working towards an adjustment, which incorporates two main issues. One is to determine the damages and the cost of the repairs of the insured property, and then we have to [inaudible] policy to determine basically three things: what is excluded, what is not part of the claim, what is included is limited or sub-limited in the policy, or what type [inaudible] finding a final amount of money that the companies will pay us.

This is a very complex exercise. It will take a lot of times to be resolved, but as we continue investing in the project, the conversation we are having with the reinsurance companies is the possibility of getting an early payment, a payment on account on insurance terms, that is basically on allocated amount of money, that as the numbers mature and the numbers are agreed, will then be allocated to that, so this year we expect to receive between USD 100 and 200 million in cash from the reinsurance companies.

Finally, on the divestment plan, we are in the final stage of the ISA shares selling. People are interested in this and are working on the transaction. We should receive an offer very soon. On that point, I'll just say that the government just today announced -- the Minister of Finance announced that they have changed plans and are not selling their shares in ISA.

Then, on next page, Cururos, as I mentioned, we expect to receive the money very soon and ADASA, we are expecting to receive binding offers here in the next few days and depending on what comes from the potential acquirers, we will proceed with the transaction. We're committed and continue working on that divestment program as planned since the Board of Directors approval back in July of last year.

That concludes our prepared commentary. Open to address any questions that you may have. I'll highlight again very solid growth, solid operational performance. We continue operation on Ituango. We are making technical progress. We still have a lot of work to do to actually resolve the whole situation. We still have more than two years to resolve it but the schedule currently is as planned for December 2021.

Operator, I go back to you.

Operator: At this time, I would like to remind everyone in order to ask a question, simply press * then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. We will pause for just a moment to compile the Q&A roster.

At this time, we are going to reply to the questions first from the audio conference and then questions from the web.

We don't have audio questions. We'd like to read a question that we received via webcast.

The question reads, "Could you please give us some details about the EP Río merger?"

Jorge Tabares: Sure. This is – the bondholders by the Colombian [inaudible] approve any merger and despite this one being non-material from the financial perspective, we have to go to the bondholders to get that approval. Strategically, this is very important. This is a territory next to the city of Medellín. This is a company we acquired about three years ago for a nominal amount with the intent to improve the infrastructure and enable the growth that was developing in the area so in terms of financial, the metrics, assets, liabilities or equity compared to EPM is less than 0.2% than EPM so the financial impact is not meaningful.

Operator: Thank you. We received another question via webcast. The question reads: "What is the estimated debt Ebitda ratio to the end of the year?"

Jorge Tabares: Thank you. We are estimating to be very close to the 3.5 target that we have for this depends on the US/COP end of the year, but it should be a number close to 3.5. Perhaps slightly above 3.5, but not significantly.

Operator: Thank you. We are checking the roster queue to see if there are any more questions.

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

Jorge Tabares: Thank you for the participation in the quarterly call. We remain open to provide any answers that may arise after this call. Our investor relations team is quite keen on receiving those questions and answering those. Thank you very much.

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