codensa emgesa

Grupo Enel

Conference Call Codensa and Emgesa
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Good morning and thank you for joining us today in our investor conference call. My name is Leonardo Lopez, Finance and Insurance Officer of Emgesa and Codensa, and today I will present to you the financial and operating results for the first half of 2018. As always, we will have a Q&A session at the end of this presentation. Questions can be asked either in English or Spanish, and will be solved by any of our team members available for this meeting. You will also be able to download this presentation from our websites.

Let's start with the highlights for the period:

Enel Group companies in Colombia showed mixed results over the first semester of 2018. Emgesa and Codensa generated a total Net Income of COP$795 thousand million pesos during the first half of 2018, equivalent to a 8,9% increase compared to the same period of 2017. On the generation business, Net Income rose by 20,1% whereas on the distribution front, EBITDA decreased by 6,3%.

During this period, Emgesa became the largest generation company in Colombia measured by net installed capacity. The increase in the capacity of the Tequendama plant to 56.8 MW, helped the company to achieve this important milestone.

Total capex for the companies reached COP$407 thousand million from which the distribution business showed a 21,1% increased over the analyzed period on an annual basis. As we have mentioned before, these investments seek to improve quality of service through the implementation of telecontrol among other technologies, while strengthening the existing network and allowing its expansion throughout new connections.

Starting on the Generation business, after the emergency declared in the Ituango hydroelectric project last April, the Energy and Gas Regulation Commission, CREG, issued several resolutions, which are currently under consultation, which seek to ensure the supply of energy for Colombia in the next few years, given the expected delay of the Ituango project and the energy supply deficit that would be presented according to the expected demand. Next, we will briefly discuss some of them:

- **Resolution 064:** According to an study of the expected demand and supply of energy available for the coming years made by the CREG, it was identified that an energy deficit would be presented by the year 2023, which explains resolution 064 proposal to carry out an auction for the assignment of reliability charge for the 2022-2023 period.
- **Resolution 066:** After carrying out the energy supply and demand analysis, CREG believes that it is convenient to have an additional mechanism to the reliability charge auction that allows the incorporation of additional firm energy to the system. In this auction, new and special plants could participate receiving up to 10 years of firm energy obligations.

- **Resolution 083:** Seeks to carry out a managed allocation of the reliability charge among the existing plants for the 2019-2020, 2020-2021 and 2021-2022 periods. With this, CREG seeks to ensure the supply of the energy demand for a period at least as long as the planning period and later be able to call an expansion auction for the period 2022-2023, of which resolution 064, explained before, takes over.
- **Resolution 084:** Annually, CREG calculates the difference between the firm energy obligations for a full year and the projected demand for the same period. When analyzing the period 2018-2019 it is concluded that the energy obligations are higher that the expected demand, therefore the regulator can carry out a reconfiguration auction to sell part of the energy obligations previously assigned, with no risk on the energy supply.

In addition to the above, CREG published draft Resolution 068 which shares the principles and conditions that energy transactions mechanisms must comply with, in order to recognize its prices within the cost component of energy purchases to the regulated user.

Turning to the Distribution business, Ministry of Mines and Energy published decree 943 regarding public lightning. The document announce important changes that has an impact in definitions of the service, duties of municipalities, define guidelines for technical studies and technical criteria in terms of taxation and finally propose the methodology to define cost of service. Also, CREG issued resolution 085 in which clarifies and corrects relevant aspects of the new remuneration methodology for the distribution activity published through resolution 015 back in January 2018. The changes were made after several requests from agents of the distribution segment such as Codensa.

In the generation business, net installed capacity at the end of June 2018 totaled 3,504 MW presenting an increase of 1.1% compared to December 2017 due to an increase in the capacity of the Tequendama plant to 56.8 MW. Therefore, currently Emgesa is the largest generation company in terms of installed capacity in Colombia.

During the first semester of 2018, Emgesa's generation reached 6,746 GWh, equivalent to a decrease of 9.4% compared to the same period of 2017. The decrease is due to the company’s strategy to cover its commitments by purchasing energy in the spot market taking advantage of a low prices scenario. Hydro generation decreased by 9.8% in line with the proposed strategy whereas thermal generation increased 13.2%, explained mainly for required backup generation during February in order to ensure the supply of energy in the Caribbean region.

Moreover, energy sales during the first half of 2018 increased by 1.8%, reaching 8,843 GWh. Analyzing the sales by Market there is an increase of 3.4% in the energy sold through contracts while transactions in the spot market dropped 5.2% in annual terms. The above is in line with the company's strategy of increasing its sales in contracts to obtain better price conditions, especially in long-term contracts of the wholesale market, all in a context of low prices in the spot market. As a result, the company's energy purchases increased 63.1% during the first semester of 2018 compared to the same period in 2017, considering the lower generation observed over the period.

Turning to the distribution business, energy distributed by Codensa during the first 6 months of the year reached 7,324 GWh, growing 1.1% compared to the first semester of 2017. This behavior is explained by an increase in regulated demand of 2.1% driven by residential and commercial segment consumption. It is important to note that even though demand through tolls has decreased when comparing with the same period of 2017 as a consequence of the implementation of energy efficiency and cogeneration technologies, a trend of larger consumption is observed in recent months, which could be in line with a improvement in economic activity.

Finally, Codensa holds a 21.7% market share in the country, positioning the company as the second largest distributor at the end of June 2018, measured by electricity distributed. Total customers served by Codensa reached 3.39 million and grew by 1,4% since December 2017, equivalent to about 48 thousand new connections.

Emgesa's gross margin reached COP$1.15 billion during the first half of 2018, increasing by 5.9% compared to the same period of 2017. This result is explained by:

-On the one hand, a 9.9% grow on operating revenues due to the increase in energy sales of 1.8% focused mainly on long-term contracts where better price conditions were presented compared to what was seen a year ago. In fact, there is an increase of 3.9% in the average price of contracts in the wholesale market, boosting the positive results.

-On the other hand, as part of the commercial strategy, there was an increase of 63.1% in energy purchases compared to the first half of 2017, in order to fulfill contract obligations taking advantage of the current spot market conditions.

Likewise, Reported EBITDA grew 7.1% in annual terms, driven by the positive results in gross margin and a reduction of 5,1% on fixed costs due to the elimination of the wealth tax since 2018.

Net income increased by 20.1% during the first 6 months of the year compared to the same period of 2017 after a reduction in net financial expenses (-9.2%) mainly explained by lower debt balances during the analyzed period accompanied by lower average CPI levels, an indicator to which 67% of the debt is indexed. Also, there is a lower effective tax rate compared to the previous year, following the tax reform of 2016.

Finally, net debt showed a small increase of 1.1% to COP$3.6 billion, mostly in line with the result of December 2017 and after the use of cash for dividend payments.

Codensa's gross margin decreased by 2% during the first half of 2018 reaching COP$957 thousand million. This performance is explained mainly by energy purchases made at a higher average price compared to the same period of 2017, given that the pass-through mechanism of this purchases presents a delay between costs and revenues recognition, this is temporarily impacting the margins. *(Without considering this effect, the gross margin would have increased by 4%)*

Fixed costs increased by 17.1%, mainly explained by:

- Increase in personnel cost of 10,4%, associated to staff increases for the execution of new projects.
- One-off effects, due to indemnifications for a supplier contract termination and the increase in provisions related to labor litigations for about COP$12 thousand million
- Additionally, the company is carrying out priority actions aiming to reduce energy losses, which increased operating expenses.

As a result of the above, reported EBITDA reached a total of COP$729 thousand million in the period, decreasing by 4.5% compared to the same period of 2017. Net income decreased by 6.3%, explained mainly by:

- EBITDA performance
- A 15.4% increase in depreciation after the relevant Capex execution observed during 2017.
- An increase of 2.3% in net financial expenses compared to the end of 2017 explained mainly by the increase in outstanding debt after the issuance of a bond in the local market for COP$360 thousand million in April, in order to finance the company's investment plan.

Finally, Codensa's net debt increased by 33,9% compared to December 2017 explained mainly by higher Capex execution and dividend payments.

Given the financial results previously explained for the Generation and Distribution businesses, Colombia's aggregated EBITDA totaled COP$1.78 billion, increasing 2.0% with respect to the first half of 2017, supported by the performance of the generation business. Taxes and net financial expenses showed an important decrease driven by the reduction of the effective tax rate after the 2016 tax reform and by an important decrease in financial expenses, especially in Emgesa.

After all of this, Net Income in Colombia achieves a remarkable total of COP$795 thousand million, growing 8,9% compared to the first half of 2017.

Cash EBITDA reached $1,02 billion pesos. Net working capital reduced cash by COP$93 thousand million, financial expenses by COP$198 thousand million and taxes by COP$390 thousand million. As a result, Funds From Operations were COP$341 thousand million. CAPEX amounted COP$73 thousand million, out of which 62,8% was aimed at maintenance, and the rest at growth. Finally, after paying COP$368 thousand million in dividends, Net Free Cash Flow for the first half of 2018 was negative by COP$101 thousand million.

EBITDA amounted COP$711 thousand million. Net working capital decreased cash by COP$194 thousand million, financial expenses reduced it by COP$69 thousand million and taxes paid by COP$266 thousand million. As a result, funds from operations amounted COP$171 thousand million.

(Net working capital deterioration is due to normal business seasonality and relevant cash outs related to capex accrued during the last quarter of 2017)

Total Capex for the first semester of 2018 reached COP$334 thousand million. The company has an important investment plan aimed at the improvement of quality indicators, modernization of the network and new connections. After paying net dividends of COP$263 thousand million, Net Cash Flow showed a negative result of COP$425 thousand million.

As of June 30th 2018, Emgesa's gross debt amounted COP$3.9 billion, decreasing by 7.6% compared to December 2017.

Throughout the first half of 2018, Emgesa paid several financial obligations entirely with cash on hand as follows: i) COP$100 thousand million on a bank loan maturity in February ii) COP$147 thousand million of a bond maturity and iii) COP$20 thousand million amortization in bank loans. The average cost of debt in Emgesa during the period decreased from 8.37% in 2017 to 7.93% as of June 2018, mainly explained by lower CPI levels registered throughout the year compared to the average of 2017. As of June 2018, 67% of the coupons of the company's outstanding debt were indexed to CPI and 6% to IBR (Interbank Rate).

For the distribution business, as of June 2018 Codensa's gross debt totaled COP$2,2 billion, a 18,5% increase compared to December 2017. Over the month of April, the company issued a two tranche bond in the local market for COP$360 thousand million with the following conditions: a 7 year tenor at a yield of 6.74% and a 12 year tenor at a CPI + 3.59% yield. This issuance was 3.3 times oversubscribed, and over 2018 continues as one of the offerings with the largest demand in the local capital market.
Codensa's average cost of debt in the period decreased from 8.20% in 2017 to 7.47% as of June 2018, explained by the remarkable long-term financing rates obtained with the local issuance commented before and lower CPI levels. As of June 2018, 37% of the coupons of the company's outstanding debt were indexed to CPI, and 3% to DTF (deposits rate).

Please note that 100% percent of both Emgesa's and Codensa's debt is held in Colombian Pesos,, considering that the companies' assets and margins have little to none exposure to foreign currencies. Total liquidity in Emgesa and Codensa reached COP$ 5.4 billion, including cash balances, uncommitted and committed credit lines with local and international banks.

As you have seen throughout the presentation, the operation for Enel Group in Colombia is positive in terms of net income but show mixed results for the first half of 2018, which was the product of our business lines as follows:

-The Gx business showed an important growth, as a result of an effective commercial strategy aimed to optimize energy sales through long-term contracts with wholesale and non-regulated costumers, during a low spot price environment.

-The Dx business had a decrease in its results during the first half of 2018, mainly due to a temporarily pass-through effect, as already was explained.

It is also worth highlighting that the Group have executed an aggregated capex of COP$407 thousand million, still focused on the Distribution business, especially on the improvement of quality of service, modernization of our network and new connections and added value services.

This ends our presentation for today, thank you very much for your attention, and do not hesitate to contact me or the Investor Relations team at anytime if you need any further information.

We will now open the call for the Q&A session. We will have representatives from other areas of the company joining us for the Q&A session. The transcript of the conference call and the Q&A session will be available in our web pages in the following days.

Ricardo Sandoval. Buenos Días muchas gracias por la presentación, me gustaría hacer una pregunta en CODENSA. Hemos estado viendo unas presiones en el Ebitda y hemos visto la deuda neta incrementarse por el plan de capex que tienen para la compañía. Considerando un capex de 3.2 billones para los próximos tres años, a mí me gustaría saber deporto el nivel de deuda neta Ebitda con el cual ustedes se sentirían cómodos o el nivel deuda neta Ebitda al cual pues podría llegar como máximo la compañía. Gracias

Ricardo, thank you. With respect to that concern, because our projections for the next few years are about the framework of never going beyond 1.5. In this order of ideas because we are indeed in the most intensive stage of the investment plan, which is why we will move between 1.2 1.3 1.5 at most 1.5 worse than never more than 1.5 in the next 3 or 4 years when we are already | finishing the investment plan that we have now underway.

Diego Buitrago. Thank you very much for the presentation. I would like to ask two questions. One is for Emgesa and is facing the resolutions of the Creg that are being raised by the Ituango contingency, Emgesa has projects to present in the cargo auctions for new plants beyond 2020? And how are you seeing the issue or let's say the possibilities of child phenomenon for the beginning of the other year end of this? And in the case of Codensa, after that investment plan is it possible to know what would be the impact on Ebitda of Codensa once the investments being made by the company are materialized? Thank you very much.

Well, with regard to the concern for the issue of reconfiguration auctions, of the next few years with the issue of the novelty of Ituango, effectively in the generation business there is a lot of interest to participate in these auctions and for that we are considering if the thing is positive and even go to a reconversion project of the thermal power plant that we have in Cartagena to go to an open combined cycle if and only if the auctions actually accompany this project. In this order of ideas it is indeed an intension of the company you take position in this new auction. With regard to the phenomenon, the child already gives you the answer. This week the Ideam public an official document where it already speaks of a forecast and phenomenon of the child by the end of this year of 60%, then with this information is that Emgesa is reviewing all the technical and operational conditions of their plants. With regard to the impact on Ebitda in the distribution of the Capex that is being invested at this time, we have the answer here. Remember a bit that we have an expectation of change in the regulatory rules let's say fundamental, remember that in January as we mentioned there resolution 015 was published.

That resolution gave us a first deadline until July 19 to send the request to the regulator of new distribution charges based on the new rule, that deadline was even extended to 2 more months however Codensa was ready and I submit in effect on July 19 the request for new positions now let's say we are waiting for the regulator Well, now to regulate the approval. Hopefully, as this is our expectation that this year will be achieved in such a way that by 2019 we hopefully have this new position and with the new methodology in application. In this order of ideas if the new regulation comes in, remember that the Ebitda is directly proportional to the new investment to the investment made plus the incentives derived from the regulation associated with the investment. Basically, if you improve the quality, then they will give you an incentive that is proportional to the value of the investments of each year. In that sense then under the new regulation the impact on Ebitda is directly proportional to the investment made.