Conference Call Transcript
1Q22 Results
Aeris Energy (AERI3 BZ)
May 13, 2022

Operator:

Good morning, everyone, and thank you for waiting. Welcome to Aeris Energy 1Q22 results conference Call. With us here today, we have Mr. Bruno Vilela, CEO of Aeris Energy, and Mr. Bruno Lolli, Chief Planning and Investor Relations Officer.

This event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After Aeris Energy remarks, there will be a question and answer session. At that time, further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

This event is also being broadcast live via webcast and may be accessed through Aeris Energy website at www.ri.aerisenergy.com.br, where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event has concluded.

Those following the presentation via the webcast may post their questions on our website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward-Looking statements are based on the beliefs and assumptions of Aeris Energy management and on information currently available to the Company. They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Bruno Vilela. Mr. Vilela, you may begin your presentation.

Bruno Vilela:

Good morning. Good morning, everyone. First, we would like to thank you all for attending. One more go to discuss the results of Aeris.

Let us start the presentation on slide number two, where we show the highlights of the 1Q22. We have three main topics that we would like to talk about separately when we look at a company or a market in the short, medium and long terms.

When we talk about markets in terms of long term, what do we see in the wind energy market in the long run? As we have mentioned with you and discussed, there is an energy transition. We need to have more renewable energy, clean energy added to the world energy matrix in general to solve the weather issue, the climate change issue.

This is something that has been addressed by several companies. We have been to the Copenhagen conference, the COP last year, and all countries committed to increase renewable energy.

But what happened in the 1Q22? Unfortunately, the conflict in Ukraine is something that is a reality, although nobody likes that. The war between Russia and Ukraine caused another point to be raised, which is energy security. It is something that is well known and widely discussed in the media, that all countries in Europe fear lacking energy, or suffering from the high cost of energy, because they all depend heavily on the gas that comes from Russia.

So cutting the gas supply from Russia is something they cannot do because they depend on that. So the cost of energy in Europe is very high at the moment.

But what really causes each country and each government to reflect on and make decisions is that they can no longer depend on any other country, whether Russia or other countries. So it becomes a national security issue. And then all countries in Europe, with no exception of that region, more than doubled their demand for renewable energy in the medium and long term.

Why renewable energy and not other source of energy? Because it is the cheaper energy. A clean energy that needs to be installed to be productive, and it is quickly installed. In the very short term, of course, they will turn on any thermal plant that needs to be turned on. But the goal is to grow exponentially in the installation and deployment of wind complexes, onshore and offshore.

Looking at the medium term, we want to highlight this because of various reasons. The first one is that “oh, people say that the wind the demand for wind energy will grow a lot, and it is almost infinite”. Well, it is a reality. But why do not we see it now or in coming years? Because we are still suffering from high inflation in commodities prices that have a high impact on the price of energy, and our end customers are discussing on how to have the new contracts signed.

First, what is the fair price? The current price of turbines considering the increase in raw materials. Also, these are short term contracts that are signed in the short term, but they are to be installed in the medium term, two to three years from now.

So what would be the adjustment criteria for future price fluctuations of raw material? So there is a lot of negotiations that are taking place, there is a lot of demand for new deployments. Negotiations are taking place. Our customers have shown, and our reports point out to an increase in the price of wind turbines of about 30% in the cost of wind energy, and still wind energy will be more competitive because all sources suffered from the inflation of raw materials. And we know that there will be a boom for the demand for wind energy in the medium term.

In the short term, most of our industry, our customers and competitors, have heavily suffered from the increase in the price of raw materials, because they are not able to pass through this price increase to their customers, and their reserves is not up to what the industry needs to continue to grow, given the high demand.

Where is Aeris inserted in this short, medium and long? When you look at the short term for Aeris, we are talking about the focus on quality. This is our in-house mantra. We say that every day, in all important events we have at the Company.

And why is that? Because when we talk about quality, that means efficiency. In this industry, we cannot talk about efficiency without thinking of quality. Everything we do aims at having a maximum possible return at the 10 GW that we have to return. We want to have the maximum financial return with this backlog that is guaranteed.

How can we do that? With quality? Without quality, we have a high repair cost. There are many products that are a work in process. So the cost of not having quality in this industry is very high. So our focus is on solving and enhancing quality in processes and products, as well as in any relationship we have.

When we speak about inflation in the medium term, all contracts already include a clause for transfer of raw material inflation, or changes in raw material prices, either up or down, that will be passed through to customers. We are impacted with the need for working capital, because more costly raw materials cause our inventory to be more expensive.

In the medium term, there is the issue of renewal of some lines that are ending in coming years. There is one to end at the end of 2022 and others in 2023, and we are very optimistic that we will be able to renew this in the 2H22.

In the long term, we are analyzing the market closely and talking to our customers to define where will be the best place and the best market for growth. The demand will grow, and this is clear for everyone. On the other hand, the number of companies that operate in this market is not growing. There are a lot of barriers to entry, so we frequently talk to our customers about future growth opportunities. We are looking at the onshore as well as at the offshore market, and also getting ready for this expansion.

On capacity, we are focusing on quality standardization, but when we need to expand to grow, going to other countries, we have plans to use all the learnings we have had and suffer less from a new greenfield project based on the lessons learned here.

These are the highlights for the 1Q22. Now moving on to slide number three, we have the main indicators for the 1Q. I am not going to go into detail, but the indicators are just to give you an overview, because we will discuss the impacts on each one during the presentation.

Looking at slide number three, we had a net income of R$1.2 million in the 1Q22, a ROIC of 9.3%. We are reducing the need for investment. The CAPEX was much lower in this 1Q22, R$29.4 million. This was used to finish some lines that were not mature. We have a net revenue of R$536 million and an EBITDA of R$54.3 million in the 1Q.

Now moving on to the next slides, we will talk more in detail about the indicators, and I turn the floor over to Lolli.

Bruno Lolli:

Thank you, Bruno. Good morning, everyone. On slide number four, let us talk about the return on invested capital, ROIC. We are growing less intensely in terms of the need for total capital, its need for working capital more than fixed assets investments. And the growth of working capital is non-recurring, it is a very specific case. It will be offset throughout the year.

When we look at the last 12 months, NOPAT, there was a reduction which is highly associated to the proportion of nonmature lines. We transitioned three lines in the previous quarter. In the beginning, they have negative reserves, until they are mature in one year to become positive in terms of results.

Slide number five, the ROIC dynamics. Something particular to this period, a very low net income, 67%. So we preferred to normalize the data to present it to you the blue part. So some important highlights, in the preoperational lines, they no longer exist. All lines are already deployed. Capital continues to be allocated to nonmature lines with a zero return.

And when we look at mature lines, we have a normalized return of 20% on year. It is slightly below what we price and believe it is optimum. There are some performance effects, but we continue to work to keep return levels at least at 20% for mature lines.

We had in this quarter a performance this lower than history, the seasonality, which is natural, but it was colder than usual for this time of the year. So the level of sales in the U.S. in this quarter was much lower than what we had before, and it will recover during the year.

Slide number six, let us talk about net revenues. From the 2Q21 to the 3Q21, we continued to grow in the domestic market, in the orange bar, and reducing the volume of exports. From the 3Q21 to the 4Q21, we had the transition of lines dedicated to experts. There were four lines, and now there are only two lines dedicated to exports, which explains the reduction in exports.

This quarter, we started with more than 80% of sales for the domestic market, and on average, we will have for the rest of the year 85% to 90% of sales to Brazil.

Slide number seven, despite this challenging environment, we have a margin of more than 10.1% and an accumulated EBITDA in the last 12 months, around R$240 million. A good portion of the EBITDA is generated by the mature lines.

Number eight. As Vilela mentioned, there has been an important reduction in the CAPEX volume in this quarter. There is still a volume to be dedicated to investments in the 2Q and 3Q associated to the completion of installation of machine and equipment, four lines that are not mature and will become mature during the 2H22.

Slide number nine. In a relationship with one customer, we had volumes lower than projected initially, and the decision to purchase raw materials is something we make five or six months before production. So when there is a production plan that is not fulfilled, naturally, in the beginning, we have an excess of inventory of raw material, around R$100 million in this quarter. But then, throughout the period, we use up this inventory. So we adjusted the purchase of new raw materials.

This new sales plan is according to the guidance margins that we have published, but it will affect the need for capital, and this effect will be seen more intensely as of the 2H22.

Debt amortization. Given this effect of increase in inventories, there was a cash burn in this quarter. We had a cash position of R$740 million, and when we look at the debt profile, we have a very long debt profile that will mature in 2020, accounting for 7% of the total indebtedness of the Company.

On slide 11, Vilela mentioned about the backlog, more than 10 GW. When we look at the final position of 2020, it was 8.8 GW, in 2021 we produce 3 GW and sold 6 GW. So we grew the backlog on an annual basis. When we see the consumption of backlog, it is basically associated to production, so the lines are delivering what they are expected to deliver for this stage of maturity.

Current production is 8.7 billion, an average power for a 5.1 MW. And it is important, now, moving on to slide 12, we continued negotiating. There are eight lines whose contracts will end in 2023 and we want to extend those contracts, and we can replace them with products that are more in demand. This is the last movement in terms of production line in 2022 in terms of decommissioning.

Now, on slide number 13, looking at the results of the 1Q, based on all the important indicators, we delivered what was expected in terms of results. There is nothing to be revised on the guidance. So the result projected for 2022 is maintained.

Since the volume was low in the 1Q, volumes will grow in the next quarter. So in the 2Q, we project a 40% growth in MW delivered, and naturally, the financial and economic results will accompany the same trend.

With that, I finish our presentation and I turn the floor over to the operator.

Lucas Laghi, XP Investimentos:

Good morning, I have two points that I would like to have more context. This revenue dynamics, more specifically the performance of production volume, there are two factors that have impacted the quarterly volume performance: the transition of lines from the 2H21, which increased the share of nonmature lines and invested capital, and changes in production caused by change of customers in this project, which caused an operating revenue of R$23 million. So how much could the revenue have grown year on year if we could compare before the transition of lines in the 2H, if we exclude these two effects, the loss of freedom, production and transition? And also, which one was more relevant in terms of impact?

Secondly, I would like to understand from you the mitigation of these production losses caused by the change of customers and projects. This mechanism protects EBITDA because of the contract, or part of the EBITDA, maybe the 60% related to the capacity of the slots. Does it only protect the added value without remuneration of raw material? I would like to understand this mitigation mechanism. Do you expect these changes to continue during the year, or should it go back to normal soon? Thank you.

Bruno Lolli:

Thank you, Lucas. I will start with the second question. This loss of volume we had to do a change of guidance from customers, the agreement we have protects the added value per quarter. So we are not compensated by the raw material gains, but at this stage of the project, they are very small.

In practice, it protects the projected EBITDA for this quarter. This rule is valid for following quarters as well. So it is likely that throughout the year, the volumes will be a bit lower than what we had projected for this customer, but keeping the same nominal EBITDA value considering always the stage of maturity of the lines.

When we speak about the differences in drop in volume in these two quarters, the most important part is associated to the transitions made from the 3Q to the 4Q. We had four lines at the maturity level, we discontinued two of them and installed three new lines. These three new lines are generating a very low volume, and the two discontinued lines account for 80% of the drop in volume we had.

So if it were not for this transition, we would have delivered about 750 MW, and we delivered 630 MW. So the volume forecast for these customers that had a change in design was low initially, so it does not matter affect the volumes delivered in the quarter materially.

Like I said, we have a very significant growth projection of at least 40% in the volume delivered in the 2Q. This is associated to nonmature lines. So we have growth with this customer that changed the guidance, but the most significant growth relates to the three lines that we installed at the end of last year.

Bruno Vilela:

When we make this negotiation of change of model, of course we have to meet the customer demand because that is the product we are selling in the short term. But we were able to recover that. As executives, we look at the long term and the ROIC of the project. So certainly, this was taken into account in this transition of the models of this customer and all customers. So either we capture more demand in the future, and we try to make the contracts safe in the long run.

Lucas Laghi:

Okay. It is clear. I believe this transition of the blades is more of a structural issue, and natural, given the business model. Our question was more related to the change in the contract, in which you lose the EBITDA that would remunerate the raw material, thinking about a more normalized production cycle. So the transition is natural, but there was this point that we needed to understand better.

As Lolli said, it does not affect it now because of the structure, but if this scenario does not normalize, maybe EBITDA will be lower than expected, because you are not remunerating the raw material. Did I understand it correctly? Lolli, you said 40% in the 2Q22. Would it be quarter on quarter?

Bruno Lolli:

Yes, quarter on quarter, Lucas, of this growth, and more than 10% of the 2Q when compared to the first. Yes, you are right about the evolution.

Producing lower volumes means that we allocate less material and have a lower chance of capturing any gain on the evolution of materials. On the other hand, producing less volume when we know that will happen also means less invested capital, less working capital.

So the way we make the contracts aims to protect the return on invested capital. So if we have volume until the end of the project, which is a possibility, we maintain the allocated capital volume lower than originally forecast, but we also maintain the average return on capital.

Lucas Laghi:

Okay. Thank you all, and have a good day.

Lucas Barbosa, Santander:

Good morning, Thank you for the question. Vilela raised this question about some contracts in 2023. From what I see on slide 12, there are two products, one with six production lines and one with two production lines. Can you give details on which one you are negotiating the extension for? And if it is the six-month production product, if you plan to extend all the lines or only a portion of them. If you could give us some details about that, it would be very helpful. Thank you.

Bruno Vilela:

Good morning, Lucas. Unfortunately, we cannot give the name of the customer, but this customer of six lines, we are negotiating an extension for that contract with a minimum usage of four lines, but up to six. So a minimum of four lines, a maximum of six lines. This extension would be up to 2026.

In the two lines, we are negotiating a change of model. It is not an extension in the agreement, but a change in model. But it is a not 100%. It is just the length of the blade. This is what we are negotiating.

Bruno Lolli:

Just adding on this final part, this two-lines customer, we are negotiating with them to transition to a product we already manufacture. So it is much simpler than what we had in the past, and it would probably happen in the beginning of 2023.

Lucas Barbosa:

Thank you, Lolli and Vilela. So for the customer of six lines, it will be a contract extension, not new product, and that would be for 2026. Is that right?

Bruno Lolli:

Yes, that is right.

Lucas Barbosa:

Perfect. Thank you. If you allow me to ask a second question, you were studying potentially to build an offshore plant outside Brazil. Could you give us an update on the possibility of having that project implemented?

Bruno Vilela:

Let us talk about what is going on. Let us talk about, for example, that United States and Europe. Europe will be a large market, maybe even larger than the U.S. for the reasons I mentioned in the beginning. In Europe, the permits are the main bottleneck. Depending on country, it is a very lengthy process, a very bureaucratic process.

But it has been disclosed in the media that the European Union is working on the standardization of the permit process. If that happens, demand will increase, because several complexes will be able to be auctioned. Today, only a few complexes are able to be auctioned. And then, that will decrease the dispute for prices from our customers with their customers.

So Europe is a market we are learning more about now because we see that demand is very high. But there is a potential to install a plant there, because in Europe, the need is speed, not local content rule.

On the other hand, in the United States Biden was not able to pass the infrastructure package in the Congress, and this package will define the need to install a product set so labor intensive as it is the production of wind turbine, or rather blades.

One of our customers has announced that they will build a plant there, and the other customers waiting for this plan to pass. In order to make investment decisions. The state has been defined because in the U.S. there are state benefits and federal benefits. The state that provides more benefits, and also that has more demand, is New York. So if the federal rule provides incentives and makes it feasible to actually install an offshore plant in the United States, we will have a plant in New York State.

Aeris attended an offshore event in Atlantic City last year and we could see how much this market is growing. It is growing not only in the United States, but in Europe, and will also grow strongly in Brazil, because other level companies will be in Brazil. Oil and gas companies will be in the offshore market.

There are more than 100 GW projects that are shown. Shell has a very large portfolio of offshore projects in the U.S. But 100 GW offshore in the United States, and our matrix less than double of that, 180. We will never have such an offshore demand in Brazil, it is true.

This is not for domestic consumption. What is being planned is also to meet the needs of the European markets, since Brazil is a neutral country, politically speaking. Our companies are studying the green hydrogen, so they will use that offshore generation to be able to generate green hydrogen and export that hydrogen to Europe, and that will be done.

There are studies about the ports of Brazil that can meet the demand from offshore markets. Rotterdam Port in Europe is already linked to other ports in Europe with gas pipelines. So this is not a utopic statement. We are talking about large companies such as Shell, for example.

It is raining heavily here in Fortaleza, so we have a background noise. Let me know if you cannot hear me well.

Lucas Barbosa:

it is very clear. Vilela. Thank you very much.

Fernanda Recchia, BTG Pactual:

Hello, everyone. Two points. First, regarding the CAPEX assumptions, we have seen news that the cost of CAPEX per KW has increased about 20% in real terms. Do you see such cost increase? Is that reflected in the guidance reported to the market. Could we expect a higher CAPEX in the next quarters to reflect that?

Also, the OEM reserves have had very low margins, especially due to the increase in raw material prices. Could we expect any impact on the backlog for future years? Thank you.

Bruno Vilela:

Thank you, Fernanda. Good morning. Let me try to answer your question very objectively. When we talk about increase, this cost increase refers to the inflation that we mentioned in the beginning. The wind turbines that are being installed today or in coming months worldwide have been negotiated some time ago, maybe even before 2020. So these are contracts that are signed and implemented in the medium term.

So the negative result of our customers is because of that. They signed an agreement with the price of turbine before the inflation on the price of raw materials, and there is nothing in the in the agreement that allows them to increase the price of the turbines. They are talking about global prices, so logistics is also an issue.

This is the reason for them to have difficulty in results currently because this refers to contracts that have been signed in the past and whose price increases cannot be transferred. This is why they are sitting down to renegotiate future contracts, and this is why the demand is not growing as much as we expected, because they are now renegotiating with the owners of the wind complexes.

So when we talk about this increase in CAPEX of 20% to 30%, this is from the point of view of the investor, the owner of the complex. The CAPEX that they consider is the complex infrastructure and the turbine. So the price adjustments that our customers are passing through to the owners of the wind complexes is 20% to 30%. So for us, this will cause the results of our customers to be financially stable again.

I do not know if it is clear. If you have any questions, we are here to clarify them.

Fernanda Recchia:

Yes, it is clear. Thank you.

Heloisa Cruz, Stoxos:

Thank you for the question. Two questions. We have this vision of contracts, and ROIC is well-defined. We know that the lines have a long maturing process and we also have the ramp up fee, then you talked about the protected EBITDA, but actually what we have seen is a drop in the ROIC. So when I look at things that are not in contract, that is not so much the pandemic as a whole. So the lockdowns, absenteeism, omicron, things that are getting in the way of the performance. But this drop in the ROIC is much worse. So we are talking about an inflation that has been higher in the last months.

We know that the contracts are being renegotiated. But actually, we have seen this almost since the Company opened capital. So I would like to understand what could be included in the nonrecurring account, and what will happen. I mean, there are several lines maturing. That is a clear sign of improvement, but it would be negotiated because all the CAPEX has been installed, so EBITDA will be better. I would like you to help me have a better visibility. So the ROIC we had at the time of the IPO was for a specific moment, with many mature lines, a very few new lines, growth in revenue. There is a backlog and guidance that provides substantial increases in the next months. I mean, based on the contracts, if you could allow us to have a better reading of these reserves, I would be very thankful.

Bruno Lolli:

Good morning, Heloisa. Looking at what is nonrecurring since the IPO, omicron is not. We had an excessive absenteeism in the beginning of January but it was a very short time. It did not affect the projected volumes. We had a more important impact on the 2Q21 at the second wave of covid in Brazil.

What really made a difference were the transitions of lines that were not projected back then. We had a portfolio of contracts and it evolved, especially due to incremental development from our customers that now have different product lines with the commercial success, which generated an anticipation between the 3Q21 and 4Q21. So naturally, we start with a high allocation of capital in the beginning of the contract and a low operational result.

Something that is a nonrecurring effect but is lasting long is a logistic complexity of raw materials, because most of them are imported, and this is much worse than it used to be. The times of transit of raw materials are at least 30 days than they used to be.

We have been trying to negotiate lower terms, better payment terms with our customers. But despite that, we are more conservatives in terms of safety buffers for inventory. So we have a ROIC of 400, 500 bases, given the logistic complexity of materials. There are other factors such as location of suppliers closer, we are talking to our customers and suppliers to attract them to close to the Ericsson plant to have more speed in delivery.

Heloisa Cruz:

So the impact on inventory will cost 400 bps/500 bpd? The customer does not pay for that, is. it fully Aeris risk?

Bruno Lolli:

Correct. It is all Aeris. The customer pays for variation in logistics costs, tax costs either up or down or cost of materials, but the cash conversion is 100% on Aeris. Capital cost variation is on Aeris.

Heloisa Cruz:

OK. And in terms of revenue growth, what can I expect? And even backlog growth too. We're pretty established, but I think maybe it's more in line with what you've said.

Bruno Lolli:

Throughout 2022, we have had an important growth in delivery volume, consequently, revenues and you continue with our sales efforts to maintain the backlog at least at the current levels.

Heloisa Cruz:

Okay. Thank you.

Fredrik Nyh, Morgan Stanley:

Good morning. Thank you for the call. I have two questions. First, on the revenue from services, if you could share the prospects to grow the business in 2022. And the raw materials that you mentioned as an increase for working capital, is there any improvement expected for the 2Q? Otherwise, what do you expect it to be the when fully normalized?

Bruno Vilela:

Good morning. In services, there has been a drop in revenue in this 1Q, especially due to the winter in the United States. It was colder than expected, so it postponed the services we have contracts for. The trend is for it to continue to grow. It will grow from 3% to 5% in our revenue. So this is a market we see with a good outlook.

As for the logistics of raw material, if everything remains as it is expected to be, it tends to improve until the beginning of 2023. That is when we believe it will be normalized, because if there is any lockdowns, as it happened in Shanghai, then the world logistics will be affected.

Fredrik Nyh:

Okay, that is very clear. Thank you very much.

Operator:

Excuse me. This ends the Q&A session. Now I would like to turn the floor to Mr. Vilela for his final remarks.

Bruno Vilela:

Thank you very much for your attention. Thank you for the questions. We remain available here with our investor relation channels to answer any questions you may have, or if you want to talk about the market.

As a final message, we always say that this market we operate in is not promising, but it will grow exponentially. And when we look at that demand, customers and the global regions are expecting to have wind energy in coming years, and we are sure that the bottleneck will be the industry. So we have to be prepared for growth. Otherwise, we will not be able to implement this high demand that has been planned for worldwide.

In the short term, we face difficulties, we are used to them. Of course, we are a Brazilian company. So as Brazilians, we are used to day to day difficulties of managing a company. We know that this will be over at some point in time, and we will grow with our customers strongly when the demand. Is here and clear for the infrastructure package for the U.S. and energy needs in Europe.

As for the Brazilian market, it continues to grow strongly. There are no components available to provide to Brazil, but we know that it will continue to grow and capture these opportunities.

Thank you for attending. Have a good weekend, and we remain available.

Operator:

The conference call. If it is, energy has now ended. We thank you all for attending, and have a good day.