AES CORP
Form 10-Q
May 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2006

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 0-19281

THE AES CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**54-1163725** (I.R.S. Employer Identification No.)
4300 Wilson Boulevard, Suite 1100, **Arlington, Virginia** (Address of Principal Executive Offices)	**22203** (Zip Code)

(703) 522-1315

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

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The number of shares outstanding of Registrant s Common Stock, par value $0.01 per share, at April 27, 2006, was 658,320,997.

THE AES CORPORATION

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006

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ITEM 1. *FINANCIAL STATEMENTS*

THE AES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in Millions, Except per Share Amounts)
(Unaudited)

	Three Months Ended March 31, 2006	2005
Revenues:		
Regulated	$ 1,493	$ 1,399
Non-regulated	1,520	1,264
Total revenues	3,013	2,663
Cost of sales:		
Regulated	(1,123)	(1,032)
Non-regulated	(936)	(807)
Total cost of sales	(2,059)	(1,839)
Gross margin	954	824
General and administrative expenses	(55)	(49)
Interest expense	(434)	(467)
Interest income	116	90
Other (expense) income, net	(48)	(15)
Gain on sale of investments	87	
Foreign currency transaction losses on net monetary position	(23)	(31)
Equity in earnings of affiliates	36	25
INCOME BEFORE INCOME TAXES AND MINORITY INTEREST	633	377
Income tax expense	(195)	(147)
Minority interest expense	(87)	(106)
NET INCOME	$ 351	$ 124
BASIC EARNINGS PER SHARE:	$ 0.53	$ 0.19
DILUTED EARNINGS PER SHARE:	$ 0.52	$ 0.19

See Notes to Condensed Consolidated Financial Statements.

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THE AES CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in Millions, Except Shares and Par Value)

(Unaudited)

	March 31, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,342	$ 1,390
Restricted cash	435	420
Short-term investments	391	203
Accounts receivable, net of reserves of $276 and $279, respectively	1,730	1,615
Inventory	466	460
Receivable from affiliates	3	2
Deferred income taxes current	253	267
Prepaid expenses	138	119
Other current assets	870	756
Total current assets	5,628	5,232
NONCURRENT ASSETS		
Property, plant and equipment:		
Land	911	860
Electric generation and distribution assets	22,913	22,440
Accumulated depreciation	(6,415)	(6,087)
Construction in progress	1,524	1,441
Property, plant and equipment, net	18,933	18,654
Other assets:		
Deferred financing costs, net of accumulated amortization of $223 and $222, respectively	288	294
Investment in and advances to affiliates	670	670
Debt service reserves and other deposits	628	611
Goodwill	1,428	1,428
Deferred income taxes noncurrent	856	807
Other assets	1,672	1,736
Total other assets	5,542	5,546
TOTAL ASSETS	$ 30,103	$ 29,432
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 1,067	$ 1,104
Accrued interest	460	382
Accrued and other liabilities	2,117	2,122
Recourse debt current portion		200
Non-recourse debt current portion	1,460	1,598
Total current liabilities	5,104	5,406
LONG-TERM LIABILITIES		
Non-recourse debt	11,298	11,226
Recourse debt	4,821	4,682
Deferred income taxes noncurrent	833	721
Pension liabilities and other post-retirement liabilities	861	857
Other long-term liabilities	3,243	3,280
Total long-term liabilities	21,056	20,766
Minority Interest	1,753	1,611
Commitments and Contingent Liabilities (see Note 6)		
STOCKHOLDERS EQUITY		
Common stock ($.01 par value, 1,200,000,000 shares authorized; 657,783,516 and 655,882,836 shares issued and outstanding, respectively)	7	7
Additional paid-in capital	6,548	6,517
Accumulated deficit	(863)	(1,214)
Accumulated other comprehensive loss	(3,502)	(3,661)
Total stockholders equity	2,190	1,649
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 30,103	$ 29,432

See Notes to Condensed Consolidated Financial Statements.

THE AES CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in millions)
(Unaudited)

	Three months ended March 31, 2006	2005
OPERATING ACTIVITIES:		
Net cash provided by operating activities	$ 544	$ 518
INVESTING ACTIVITIES:		
Property additions	(232)	(271)
Acquisitions net of cash acquired		(85)
Proceeds from the sales of assets	114	3
Sale of short-term investments	276	493
Purchase of short-term investments	(444)	(335)
(Increase) decrease in restricted cash	(21)	67
Proceeds from the sales of emisson allowances	44	2
Decrease in debt service reserves and other assets	9	27
Other investing	(17)	(7)
Net cash used in investing activities	(271)	(106)
FINANCING ACTIVITIES:		
Borrowings under the revolving credit facilities		10
Issuance of recourse debt	50	5
Issuance of non-recourse debt	357	411
Repayments of recourse debt	(150)	
Repayments of non-recourse debt	(590)	(586)
Payments for deferred financing costs	(16)	(1)
Distributions to minority interests, net	(16)	(21)
Issuance of common stock	8	8
Other financing		(2)
Net cash used in financing activities	(357)	(176)
Effect of exchange rate changes on cash	36	(18)
Total (decrease) increase in cash and cash equivalents	(48)	218
Cash and cash equivalents, beginning	1,390	1,281
Cash and cash equivalents, ending	$ 1,342	$ 1,499
SUPPLEMENTAL DISCLOSURES:		
Cash payments for interest net of amounts capitalized	$ 354	$ 374
Cash payments for income taxes net of refunds	$ 173	$ 73

See Notes to Condensed Consolidated Financial Statements.

THE AES CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. FINANCIAL STATEMENT PRESENTATION

Consolidation

The condensed consolidated financial statements include The AES Corporation, its subsidiaries and controlled affiliates (Company or AES). Furthermore, variable interest entities in which the Company has an interest have been consolidated where the Company is identified as the primary beneficiary. In all cases, AES holds a majority ownership interest in those variable interest entities that have been consolidated. Investments in which the Company has the ability to exercise significant influence but not control are accounted for using the equity method. Intercompany transactions and balances have been eliminated in consolidation.

Interim Financial Presentation

The accompanying unaudited condensed consolidated financial statements and footnotes have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles in the United States of America for annual fiscal reporting periods. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair statement of the results of operations, financial position and cash flows for the interim periods. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of results that may be expected for the year ending December 31, 2006. The accompanying condensed consolidated financial statements are unaudited and should be read in conjunction with the audited 2005 consolidated financial statements and notes thereto, which are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005 as filed with the SEC on April 4, 2006.

New Accounting Standards

Share-Based Payment. In December 2004, the Financial Accounting Standards Board (FASB) issued a revised Statement of Financial Accounting Standard (SFAS) No. 123, Share-Based Payment. AES adopted SFAS No. 123R and related guidance on January 1, 2006. See Note 10 to the condensed consolidated financial statements for disclosure of the Company s employee stock-based compensation and the effect of the adoption of SFAS No. 123R.

2. INVENTORY

Inventory consists of the following (in millions):

	March 31, 2006	December 31, 2005
Coal, fuel oil and other raw materials	$ 225	$ 233
Spare parts and supplies	241	227
	$ 466	$ 460

3. LONG-TERM DEBT

Non-Recourse Debt

Debt Defaults

Subsidiary non-recourse debt in default as of March 31, 2006 is as follows (in millions):

Subsidiary	Primary Nature of Default	March 31, 2006 Default	Net Assets(1)
Eden/Edes	Payment	$ 85	$ (7)
Parana	Material adverse change	33	(75)
Hefei	Payment	4	27
Ekibastuz	Covenant	3	75
Kelanitissa(2)	Covenant	65	36
		$ 190	

(1) Net assets are presented only for those subsidiaries with secured debt in default at March 31, 2006.

(2) As of April 30, 2006, Kelanitissa was in violation of a covenant under its $65 million credit facility because of a cross default to a material agreement for the plant.

None of the subsidiaries listed above that are currently in default is a material subsidiary under AES s corporate debt agreements in order for such defaults to trigger an event of default or permit an acceleration under such indebtedness. However, as a result of additional dispositions of assets, other significant reductions in asset carrying values or other matters in the future that may impact our financial position and results of operations, it is possible that one or more of these subsidiaries could fall within the definition of a material subsidiary and thereby upon an acceleration trigger an event of default and possible acceleration of the indebtedness under the AES parent company s outstanding debt securities.

Recourse Debt

Recourse debt obligations are direct borrowings of the parent corporation.

On March 3, 2006, the Company redeemed all of its outstanding 8.875% senior subordinated debentures (the Debentures) due 2027 (approximately $115 million aggregate principal amount). The redemption was made pursuant to the optional redemption provisions of the indenture governing the Debentures. The Debentures were redeemed at a redemption price equal to 100% of the principal amount thereof, plus a make-whole premium of $35 million determined in accordance with the terms of the indenture, plus accrued and unpaid interest up to the redemption date.

The Company entered into a $500 million senior unsecured credit facility agreement effective as of March 31, 2006. The Company had no outstanding borrowings or letters of credit outstanding against the senior unsecured credit facility as of March 31, 2006. On May 1, 2006, the Company exercised its option to extend the total amount of the senior unsecured credit facility by an additional $100 million to a total of $600 million. The credit facility will be used for general corporate purposes and to provide letters of credit to support AES s investment commitment as well as the underlying funding for the equity portion of its investment in AES Maritza East 1 on an intermediate-term basis. AES Maritza East 1 is a coal-fired generation project that is expected to begin construction in 2006.

4. EARNINGS PER SHARE

Basic and diluted earnings per share are based on the weighted average number of shares of common stock and potential common stock outstanding during the period. Potential common stock, for purposes of determining diluted earnings per share, includes the effects of dilutive stock options, warrants, deferred compensation arrangements, and convertible securities. The effect of such potential common stock is computed using the treasury stock method or the if-converted method, as applicable.

The following table presents a reconciliation (in millions except per share amounts) of the numerators and denominators of the basic and diluted earnings per share computation. In the table below, income represents the numerator and shares represent the denominator:

	Three Months Ended March 31,					
	2006			2005		
	Income	Shares	$ per Share	Income	Shares	$ per Share
BASIC EARNINGS PER SHARE	$ 351	657	$ 0.53	$ 124	651	$ 0.19
EFFECT OF DILUTIVE SECURITIES:						
Convertible securities	7	19	(0.01)			
Stock options and warrants		10			11	
Restricted stock units		2			1	
DILUTED EARNINGS PER SHARE	$ 358	688	$ 0.52	$ 124	663	$ 0.19

There were approximately 7,808,803 and 8,609,769 options outstanding at March 31, 2006 and 2005, respectively, that were omitted from the earnings per share calculation because they were anti-dilutive. In addition, all convertible debentures were omitted from the earnings per share calculation for March 31, 2005 because they were anti-dilutive.

5. SUMMARIZED INCOME STATEMENT INFORMATION OF AFFILIATES

The following table summarizes financial information (in millions) of the entities in which the Company has the ability to exercise significant influence but does not control, and that are accounted for using the equity method.

	Three Months Ended March 31,	
	2006	2005
Revenues	$ 232	$ 250
Gross Margin	$ 56	$ 77
Net Income	$ 56	$ 51

In accordance with Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, the Company discontinues the application of the equity method when an investment is reduced to zero and does not provide for additional losses when the Company does not guarantee the obligations of the investee, or is not otherwise committed to provide further financial support for the investee. The above table excludes income statement information for the Company s investments in which the Company has discontinued the application of the equity method. Furthermore, in accordance with APB 18, the Company s policy is to resume the application of the equity method if the investee subsequently reports net income only after the Company s share of that net income equals the share of net losses not recognized during the period the equity method was suspended.

In March 2006, AES s wholly-owned subsidiary, AES Kingston Holdings, B.V., sold 100% of the shares of AES Kingston LLC which held an indirect ownership interest in Kingston Cogeneration Limited Partnership (KCLP), a 110 MW cogeneration plant located in Ontario, Canada. AES received $110 million in net proceeds for the sale of its investment and recognized a pre-tax gain of $87 million on the sale.

6. CONTINGENCIES

Environmental

The Company reviews its obligations as they relate to compliance with environmental laws, including site restoration and remediation. As of March 31, 2006, the Company has accrued liabilities of $12 million for projected environmental remediation costs. Because of the uncertainties associated with environmental assessment and remediation activities, future costs of remediation could be higher or lower than the amount currently accrued. Based on currently available information and analysis, the Company believes that it is possible that costs associated with such liabilities or as yet unknown liabilities may exceed current reserves in amounts that could be material but cannot be estimated as of March 31, 2006.

Financial Commitments

At March 31, 2006, AES had provided outstanding financial and performance related guarantees or other credit support commitments for the benefit of its subsidiaries, which were limited by the terms of the agreements to an aggregate of approximately $512 million (excluding those collateralized by letter of credit and surety bond obligations discussed below).

At March 31, 2006, the Company had $202 million in letters of credit outstanding under the revolving credit facility that operate to guarantee performance relating to certain project development activities and subsidiary operations. The Company pays a letter of credit fee ranging from 1.75% to 2.75% per annum on the outstanding amounts. In addition, the Company had $1million in surety bonds outstanding at March 31, 2006.

Litigation

The Company is involved in certain claims, suits and legal proceedings in the normal course of business. The Company has accrued for litigation and claims where it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company believes, based upon information it currently possesses and taking into account established reserves for estimated liabilities and its insurance coverage that the ultimate outcome of these proceedings and actions is unlikely to have a material adverse effect on the Company s financial statements. It is possible, however, that some matters could be decided unfavorably to the Company, and could require the Company to pay damages or make expenditures in amounts that could be material but cannot be estimated as of March 31, 2006.

In September 1999, a state appellate court in Minas Gerais, Brazil, granted a temporary injunction suspending the effectiveness of a shareholders agreement between Southern Electric Brasil Participacoes, Ltda. (SEB) and the state of Minas Gerais concerning Companhia Energetica de Minas Gerais (CEMIG), an integrated utility in Minas Gerais. The Company s investment in CEMIG is through SEB. This shareholders agreement granted SEB certain rights and powers in respect of CEMIG (Special Rights). In March 2000, a lower state court in Minas Gerais held the shareholders agreement invalid where it purported to grant SEB the Special Rights and enjoined the exercise of Special Rights. In August 2001, the state appellate court denied an appeal of the merits decision, and extended the injunction. In October 2001, SEB filed two appeals against the decision on the merits of the state appellate court, one to the Federal Superior Court and the other to the Supreme Court of Justice. The state appellate court denied access of these two appeals to the higher courts, and in August 2002, SEB filed two interlocutory appeals against such decision, one directed to the Federal Superior Court and the other to the Supreme Court of Justice. In December 2004, the Federal Superior Court declined to hear SEB s appeal. However, the Supreme Court of Justice is considering whether to hear SEB s appeal. SEB intends to vigorously pursue a restoration of the value of its investment in CEMIG by all legal means; however, there can be no assurances that it will be successful in its efforts. Failure to prevail in this matter may limit SEB s influence on the daily operation of CEMIG.

In August 2000, the Federal Energy Regulatory Commission (FERC) announced an investigation into the organized California wholesale power markets in order to determine whether rates were just and reasonable. Further investigations involved alleged market manipulation. The FERC requested documents from each of the AES Southland, LLC plants and AES Placerita, Inc. AES Southland and AES Placerita have cooperated fully with the FERC investigation. AES Southland is not subject to refund liability because it did not sell into the organized spot markets due to the nature of its tolling agreement. AES Placerita is currently subject to refund liability of $586,000 for sales to the California Power Exchange. The Ninth Circuit Court of Appeals addressed the appeal of the FERC s decision not to impose refunds for the alleged failure to file rates including transaction specific data for sales during 2000 and 2001. Although in its order issued on September 9, 2004 the Ninth Circuit did not order refunds, the Ninth Circuit remanded the case to the FERC for a refund proceeding to consider remedial options. That remand order is stayed pending rehearing at the Ninth Circuit. In addition, in a separate case, the Ninth Circuit heard oral arguments on the time and scope of the refunds. Placerita made sales during the time period at issue in the appeals. Depending on the result of the appeals, the method of calculating refunds and the time period to which the method is applied, the alleged refunds sought from AES Placerita could approximate $23 million.

In November 2000, the Company was named in a purported class action along with six other defendants, alleging unlawful manipulation of the California wholesale electricity market, allegedly resulting in inflated wholesale electricity prices throughout California. The alleged causes of action include violation of the Cartwright Act, the California Unfair Trade Practices Act and the California Consumers Legal Remedies Act. In December 2000, the case was removed from the San Diego County Superior Court to the U.S. District Court for the Southern District of California. On July 30, 2001, the Court remanded the case to San Diego Superior Court. The case was consolidated with five other lawsuits alleging similar claims against other d