

Q2 2018 Earnings Call

Company Participants

- Henrique Manuel Marques Faria Lima Freire, Vice President - Finance
- Miguel Nuno Simoes Nunes Ferreira Setas, Chief Executive Officer and Investor Relations Officer

Presentation

Operator

Good afternoon and welcome to EDP Energias do Brasil Conference Call to discuss the earnings of the Second Quarter 2018. Right now, all participants are in listen-only mode. Later on we are going to open for the Q&A session when further Instructions will be provided. (Operator Instructions) This presentation together with slides will be simultaneously webcast on the company's website www.edp.com.br/ir. And there you also be able to obtain the company's earnings release.

Before moving on EDP Energias do Brasil would like to let you know that any statements made during this conference call relative to the company's business outlook, as well as projections, operating and financial goals relative to its potential growth are based on assumptions, based on the company's management's expectations with regard to the future of EDP Energias do Brasil. Forward-looking statements depends on the country's economic scenario, the performance of the company and the regulation in the electric industry in addition to other variables that are therefore subject to changes.

Now we're going to turn the call to Mr. Miguel Setas, CEO and Investor Relations Officer of EDP Energias do Brasil, that will start the call. Please Mr. Setas, you may go on.

Miguel Nuno Simoes Nunes Ferreira Setas {BIO 15901389 <GO>}

Good morning, everyone. I would like to welcome to our conference call to release our earnings for the second quarter 2018, and to tell you that in this call I am with the company's CFO, Henrique Freire and other company officers. We are here to answer your questions about our results.

I believe that the word that summarizing the results in this quarter is something that we have been repeating in previous quarters, which is consistency. And once again we presented a solid quarter with regard to our results and I would highlight five factors -- five pillars in which this consistency shows very clear. The first, and please, I would like you to turn to page three of our presentation, are the results of the same. As you know, you saw in our release we had the best quarter in terms of availability of our history closed in the quarter with availability close to 98%.

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The second highlight is the management of our energy risk, most particularly related to the hydrological risk. As you know, we have a very proactive approach covering the GSF risk with hedge and a full coverage of the risk. And you're going to see further on with Henrique Freire, that we mitigated the GSF risk by 100% in our exposure in the uncontracted energy market, that is the free energy market.

Another point, I would like to mention is our operating performance with distributed energy, and here I would like to highlight the control of losses, commercial losses and which we recorded for 14 quarters in a row, a reduction of losses in Espirito Santo's and therefore very consistent since 2015 quarter-on-quarter showing a reduction of losses and in the case of Bandeirante EDP Sao Paulo, as we are close to the regulatory losses for two quarters in a row, we are below regulatory losses. So in two distributor companies, a good performance in losses as you're going to see further on.

The first point, I would like to mention is the delivery of our construction, as you have seen in our generators Cachoeira, Caldeirao, Jari, more recently in Sao Manoel, we have been delivering our construction before the time that was contracted. And we are doing the same interest vision and you're also going to see that further on with our performance, which what was contracted for '16 and '17 and Espirito Santo's our most advanced (Technical Difficulty) with almost 50% of completion. With leverage, that was first expected to 60% -- 70% -- 70, and now we are getting close to 92%, so those project today has a three-digit profitability, it's really doesn't -- even make sense to calculate the profitability -- the equity is so limited that the equity is almost a measure that doesn't make sense.

And the first -- the first thing, that Henrique is going to elaborate on and I think is a major accomplishment in recent years, which is cost controls, and in this quarter we had a nominal cost that has a very good number vis-a-vis the inflation rate, and therefore we are very pleased to tell you that the investments that we had in successive cycles of the zero base budget, we are in the third cycle and they are yielding positive result, and positioning the company in terms of cost that is quite effective. So these were the five elements that I would like to highlight, as the most evident in this quarters, in terms of robustness of our performance. per se hydrological energy hedge, distributed energy, completion of work quite optimized and cost control; five dimensions that are quite relevant in our work.

Now, we are going to go to page four, just to show you the numbers that you already acquainted what saw in our release per se, closing the quarter with 98% availability. And here you see that's a failure rate is already at a very optimized level, the failure rate is close to hydro plant and therefore the mill, the plant is today working with a very optimized, stabilized system, quite stable as you can see, yielding results, better results from the stabilization.

On page five, you have a summary of what you saw with regard to distribution. Again very good evolution of volumes and I here -- I would highlight that we have the average of 3.2% increase in volume and particularly in the industrial area quite consistent with those distributions 4% above in industrial lines and we're (Technical Difficulty) distributors so we see that we are recovering volumes in a very consistent manner, and that of course has

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an impact in our performance. And then the history that we have been reinforcing along the quarters, which is our CapEx that is stronger very much directed to fighting losses. And if you see our non-technical losses, we are two quarters below regulatory losses, and 14 quarters in a row of a decrease in losses in Espirito Santo, so quite a highlight.

On page six, I have a word about Celesc, you know that we started being part of the Company's governance with the appointment of three members to the Board of Directors of the company. Also the appointment of one member to the Fiscal Council and one to the statutory management. So today in Celesc, the statutory management, the controlled position is occupied by a member appointed by EDP. Also, I would like to highlight the accounting recognition of a capital gain in the company acquisition. So, as you will remember we have the first transaction and then we had a PTO, we acquired 19.62% of the company's total stake. This was considered an advantageous acquisition, because of the price that we paid per share and therefore in this quarter, we recognized 63.7 million in capital gains resulting from this acquisition. So again, that shows how correct we were with the transaction with Celesc and now with an accounting evidence of this attractiveness of the transaction.

On the next page, we have a word about commercialization, and here we have the evolution of volumes in the second quarter vis-a-vis the second quarter of '17, here it's not written, but it was the best quarter of EDP commercialization company in its history, and you're going to see we had 51 million of EBITDA, the best performance in the whole of its history, and very much leveraged by the growth of volumes.

Also on this slide, we have two strategic partnerships that are quite symbolic for the company. One, in terms of electric mobility, as you saw in recent weeks, we opened the largest electric corridor in Latin America together with Ipiranga gas stations and BMW, today you can charge your car and you can go from the Rio Sao Paulo [ph] to Sao Paulo Rio [ph] just with electric vehicles, because we have six point of fast charge in this 430 kilometers that separate the two cities. And also in Uruguay, we have 310 kilometers, which is the second largest extension, so this is a highlight for Brazil in terms of electric mobility.

To the right of the slide, this is a new segment we are going into with the commercialization company, which is the retail market. You saw that we are in the largest retail energy sale contract BRL86 million with Banco do Brasil for the supply of 24 facilities of Banco do Brasil in 12 states throughout the country.

On the next page, page eight. And now -- after that, I'm going to pass it on to Henrique. I would like to give you a note about transmission. We have already showed that in the first slide, but I would like to recover that we have 48% of the construction of Espirito Santo completed, this was relative to the auction of 2016. So today our prospect is to advance 17 month in the construction, it was quite above what we had in our business case. We were thinking of an advance below one-year, but we are already ahead of time by 17 months. And that reflects the attempt of advancing other construction lines and other lines that we contracted in 2017 that are already in the licensing project. And in our opinion they are already moving on quite well according to our expectations.

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And perhaps, we are going to have additional advances, compared to our prospects that were contracted in the auction, particularly in Santa Catarina naturally, which is a region in which we have a strategic partnership with Celesc, and this strategic partnership is adding fluidity to the relationship with local authorities, municipalities, regulatory agencies, so in our review this is already bringing additional value to the transaction of acquisition per se.

Therefore this is an area, as you know that we are very much focused on the implementation, and I believe that in the coming quarters, we'll continue to bring you good news as we brought with Espirito Santo.

Well, without any further ado, I'm going to turn it onto Henrique.

Henrique Manuel Marques Faria Lima Freire {BIO 19117781 <GO>}

Good afternoon everyone. I would like you to go to slide number nine, where we have some of our financial highlights and our main indicators. So starting with gross margin, gross margin had 11.4% above the previous quarter, the same quarter '17, and later on we are going to talk about the hydrological risk controls per se and distribution with very good results.

PMTO highlights, we had a numbers below inflation, this has been accounted to have increases below inflation and that reflects an increase of EBITDA of 11.8%.

Net income, we had a very good financial results with 227 million especially because we have the acquisition of Celesc inclusive in that. In that business, I have further on, I'd like to talk about the challenges up in that business in transmission. I would like to give you a bit of our view and CapEx, we continue with our commitment of delivering our CapEx in distribution this year [ph]. And we intend to meet our commitments.

We're going to slide number 10. We have an analysis of the hydrological risk management. First, I would like to say that the first quarter, there was a leftover of energy. In the beginning of the quarter this situation deterioration, we had the GSF of 85%, a PLD of 303. So therefore, we had a deterioration in the scenario. We have had a hedge coverage policy that is quite dynamic, and the average of the year you have in the upper part of this chart, you see that we have a hedge of 16% and if it weren't for the hydrological risk and the GSF, we would have an average coverage of 21%, but perhaps the focus here would be the expectations that we have for the second half of the year.

The expectation is to have a deterioration, because of the allocation of energy of the market for the next half of the year. So GSF is naturally going down. And today, we have a coverage of 121 megawatts, and we are talking about GSF across mostly up 30%. So we believe that for the next half of the year, we are quite hedged in the most adverse conditions.

In the bottom part, we tried to show the financial impact of our management, so you see the GSF, PLD have an impact of 115 million negative to our revenues, which was hedged by 121 million of our management. So the difference you have the GSF, the negotiation of 13

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million, the initial hedge margin of 82 and the additional hedge of 9 million. Therefore the gross margin was 242 million. So I believe that we continue to have a very active -- effective management of hydrological risks.

On the next slide, we talk about our commitment to cost control, remember that since 2015, we have our Zero-Based budget with several activities and initiatives to control cost, reduced cost with robotization, digitalization. We have become more efficient and throughout the period we had more than 150 initiatives. And then if you take a look at the expectations of the quarter, we had decreased our recurring cost by 1.4%. Just to make it very clear in this account, we are not considering the cost allocated to EDP grid, because this is an energy service, that I am providing work to third-party, I extend this business and then my cost increases. So, that wouldn't be a comparison that would make sense. So if we do remove this effect, it's not quite significant but for the purposes of comparison, this is very relevant. Therefore, we had an evolution of minus 1.4%, compared to the first half '17. Therefore we have an IPCA with growth of 4.4% that is a gross below the inflation of the period. And this size of gain of course is going to be diminished along the year, but it shows a real gain that we want to continue to capture.

Let's go to the next slide, slide number 12, where we talk about the evolution of our EBITDA, comparing last year and this year. Here we have a view of the quarter and of the half year. I'm going to focus on the half year, because sometimes the quarter is more disturbed by less homogeneous results. So perhaps this is easier to compare semester by semester, first hydro generation 11 -- above the same [ph] we are doing very well with a 105 million above last year. There are several contributions for this, the core [ph] logistics that we have been talking about last year in this half, we had BRL46 million of core logistics in the amount of the ships. And this is something we are working with, we invested a lot in that ending the first half of the year, we spent 22 million. So a substantial reduction, almost half of the cost we had last year.

And then in the previous quarter, we've had already a gain in the calculation of taxes. There is a new reference in the calculation of taxes, thus in the last quarter gave us a gain of BRL12 million and in this quarter, it was up BRL60 million, this was an additional factor. And then per se we had a huge turnaround in terms of costs, it's been three years now that we took a 100% of the partnership control, and if you compare the cost of the first quarter of -- first half of 2015 to the first half of '18, we have the real reduction of cost of 34%. So cost should be 82 million and now in 2018, it's -- they are 54 million, so a quite substantial reduction, continuous work that reflects failure rates, availability, all the parameters that we work with and per se and that we should highlight.

In terms of distribution, we had said in the last half of the year, the first quarter was positively impacted by non-recurring effect and we had a 30 million gain there. But now in the first half of '18, we are 40 million above what the first half of '17 was like, just for you to have some focus on this number; first losses Miguel mentioned that we had a positive evolution with an increase of less losses in the both -- in both distributors. We had a negative effect when we compare '17 and '18 of the tariff, remembered that the readjustments in '17 incorporated the negative IGPMs, and that reflected in an evolution of the tariff that was negative, but about 30 million. But this effect is going to be recovered

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in the next readjustments that we are going to have in Espirito Santo and later on in the year in Sao Paulo.

So we know that there was a mismatch of inflation in between the years and then we are going to see a clear recovery from now on. Also remember that last year we had an effect of over contracting that was much larger than this year, last year we had a variation of 26 million, I mean 26 million this year, higher than last year. And also in distribution, we had contingencies, we have an increase in this quarter about 13 million of this quarter. We know that contingencies can be more volatile quarter-on-quarter. Altogether, in the year, we have 25 million, if you compare to '17, we had 30, then a reduction of 7, so we should have had 37 in '17 and now we are at 25. So again, we have more impact in this quarter. As far commercialization and services, we see that the amount is above last year, we had a record quarter. And remember that the EBITDA in the commercialization company was BRL86 million, which is an exceptional result.

Now, we are going to slide number 13. Well, we show the gap and the bridge between the regulatory EBITDA and our corporate EBITDA. The highlights here; first our losses and delinquency or the provision for bad credit. So we see that losses had a negative impact of 20 million in our EBITDA. The first half was 20 -- sorry 48, so a reduction of 28 million, as we mentioned before, because of the over contracting that is a more margin of gain in this quarter. OpEx, we continue to be above regulatory and 23 million, the liquidity is 20 million in the -- last year it was 31, so it's also an important factor that we are always monitoring in a very effective way, and we are continuing to disconnect consumers and we have more intelligence in terms of technology, we are very more effective -- I have a more effective disconnection, then the effect of VNR, we had the impact of inflation and other effects.

So going to slide number 14. We have our net income, also on a quarter-on-quarter and on a semester-on-semester base, you'll see the gain of Celesc that impacted our financial results, and also remind you all, that in terms of tax rate in this quarter we have interest on equity that was not yet captured about 32, 33, so it's natural that this amount is going to be closer to 28 by the end of the year or the average of the year.

Going to slide 15, we talk a bit about our indebtedness, we continue to have a strategy of leverage, so that we can have the tax effect of the holding, that is not positive, but we are trying along the quarter to have a reduction, the cost of debt is now 9.4% and leverage is about 2x. Remember because of the review of our methodology, we have a holding and distributors that was increased and now our rating is AAA.

Talking about slide 16 some of the challenges that we have in transmission. Remember that the lots, the first we have 24 with a leverage of 92% with an issuance of debentures and now we have four lots to be financed. Remember that this lots, when we had base run when communicated to the market, we had a low one with the BNDES, but now (inaudible) we are talking to BNV [ph] and in terms of leverage that perhaps is going to be very close to that. But in terms of costs, it's going to be better than what was expected and then we have lots 18 and 21, 18 Sao Paulo and Minas and 21, Alianca in Santa Catarina and in these we are analyzing, we have the possibility of having one of issuance to the market using debenture instrument and here we perhaps that we can have leverage a

bulk, what was considered in the auction. And therefore our prospect is to take a look at the loan bridges, and ensure a controlled cost of debt, and therefore higher leverage than what we have expected, therefore increasing our PTO [ph] and our profitability.

With that I complete the financial portion, and I get back to Miguel.

Miguel Nuno Simoes Nunes Ferreira Setas {BIO 15901389 <GO>}

Okay, Henrique, thank you. Before going to the last slide, I would like to talk about the explanation of the financing of construction work and reinforce the point that he mentioned in the end about the improvement of profitability of this project. If you will remember, when we announced the results of the last auction to the market, we made the reference of an interval between 12% to 14%, which was the reference of profitability of the four projects that we were granted in the last auction. Of course with the additional advances we are working with and because we want to improve our finance conditions, we are very close to increasing this variation that we mentioned between 12% and 14%.

On the final slide, on page 17, I'm not going to go into detail, because basically what said is that we are going to continue to do more of the same. The strategy that has brought us here being extremely consistent with our results, with our operations and this is the focus of the next quarter. Of course, I cannot fail to mention the process that is going on of the public offer to acquire CTG that was already announced by EDP Energias de Portugal.

And I would like to tell you that the Board of Directors of EDP Brasil assisted [ph] by its governance assistance and related parties remember that this committee comprises independent members of the company and the Board assisted by the committee is monitoring from close (Technical Difficulty) transaction that was announced by CTG. So this a subject that is a priority for our Board of Directors, and obviously we have the prospect of defending the best interest of the company and of the shareholders that are part of EDP Energias do Brasil.

All that said, I'm going to close our presentation and we are going to open for your questions. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we'll now starts the Q&A session. (Operator Instructions) So if there are no questions, EDP Energias do Brasil conference call to discuss the earnings of the second quarter '18, is now closed. All questions taken on the webcast are going to be later on answered by the IR team. We thank you very much for attending and wish you a good afternoon. Thank you very much.

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