

Q3 2018 Earnings Call

Company Participants

- Donato Da Silva Filho, Director for Regulation and Asset Management
- Henrique Manuel Marques Faria Lima Freire, Chief Financial Officer
- Miguel Nuno Simoes Nunes Ferreira Setas, Chief Executive Officer and Investor Relations Officer

Other Participants

- Andre Sampaio, Analyst
- Carolina Carneiro, Analyst

Presentation

Operator

Good afternoon, and welcome to the conference call of EDP Energias do Brasil to discuss the Results of the Third Quarter 2018. Right now, all participants are connected in listen-only mode. Later on, we are going to start the Q&A session and we'll give you further instructions for participation. (Operator Instructions) This presentation, together with its slides, will be simultaneously webcast on the company's website, www.edp.com.br/ir. In there, you will 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 outlooks as well as projections, operating and financial goals relative to its potential growth, are based on expectations of the company's present management with regard to the future of EDP Energias do Brasil. Forward-looking statements will depend on the country's economic scenario, the performance and the regulation of the electric sector, in addition to other variables, and therefore are subject to changes.

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

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

Good morning, everyone. I would like to welcome you to our conference call of the third quarter '18. Today in the room we have Henrique Freire, our CFO and other directors of the company that will be able to clarify all your questions regarding the results of the third quarter '18. I would like to start to emphasize that this quarter once again is a quarter of consistent results, solid results.

FINAL

And I think there are three main points that will evidence the consistency of results that we have been delivering. The first has to do with the energy risk management, and we are going to talk about -- more about that during the presentation. Second, operational excellence. and here, I refer to the reduction of losses in the distributions that have been quite consistent and also the Pecem thermal energy assets that has had very good performance. So the performance of assets as a whole.

With regard to costs, we are reaping the fruit in this quarter of the continued work that we have been delivering with our Base-Zero initiative, which is core of this process and also efficiency initiatives that we have, automation and digitalization of our processes, and as obviously they bring benefits to us in terms of economic gains. The fourth point is the execution of our work. You're going to see the evolution of our work in transmission, particularly in Espirito Santo and Santa Catarina, once again, show as we have done with our electric plants, the capacity to implement our investment commitment within scheduled deadlines and even advance some of our timelines with regard to regulatory deadlines.

The first point, I would like to talk about our financial strategy and here we are going to talk about the funding of our transmission work. In our point of view, as we have already had the opportunity to talk to you about, we are having an additional value to the company. And finally, the completion of our capital recycling strategy, particularly with the sales of small electric plants, 8 small PCHs in Espirito Santo that started with the sale of Pantanal, then Costa Rica, and then this one in Espirito Santo, and we're going to talk about that. So approvals are in line without exceptions, and in a way, again, very committed towards our actions in this quarter, we were able to deliver very well.

So we're going to start with page four of the presentation, to tell you a bit about the results of our hydrologic risk management strategy. And again, this is clear evidence of the benefit that we are getting from the integrated management of generation and commercialization units. As today, as you know, Group structure is headed by the same Vice President and this integrated action of the two business lines have given us significant results. You see on page four, we have a potential loss of BRL441 million in the quarter, which is offset or mitigated by the risk-averse strategy of BRL361 million, not considering the positive impact of the commercialization company. If we did so, then together with the hedge of Pecem, a full hedge, we would have the loss of GSF and hydrological risk completely mitigated. And the fact is shown here, and it is also confirmed by the numbers here to-date. So this strategy has been very well implemented in the first nine months of the year.

On the next page on page five, we have a reference on Pecem. As you know, Pecem has had a very good stability of its operating performance. And now with what we have in the programmed maintenance that started this quarter of Unit two. So we have the availability of (inaudible) that corresponds to downtime of the program and maintenance, but still we are very close to 90% in terms of our availability. And later on, Henrique is going to show you the economic data that are differentiated for this asset.

On the next page, on page six, we are going to talk about distribution. So we have the recovery of our numbers in Espirito Santo, an increase of 7.7%, in Sao Paulo an increase of

2%. So we have an increase of 4.2% all together -- of increase altogether. So this is a sign of an evidence of a recovery, economic recovery and the recovery of numbers that have been consolidated along the quarter.

And also, more concretely speaking in the investments in this business unit, what we see is a reinforcement of the investments that were allocated to distribution companies, so that we can get to the end of the year with 630 million, which corresponds a CapEx over or the ratio of two times. In the past, we were closer to the reintegration quota and now we were able to recover the investment in distribution. Of course, we were going to have concrete results in the next tariff review in the year of 2019 for both distributors.

And in the bottom, you can see on page six, the evolution of losses. In Sao Paulo, non-technical losses, for three quarters in a row are below the regulatory losses and Espirito Santo for 14 quarters in a row with reductions, which leads us to a margin of 40 basis points above the regulatory landmark. So in the case of Espirito Santo and Sao Paulo, we have reached the regulatory landmarks, which was one of our commitments. And so we even advanced the timeline to meet this objective the subject. We wanted to get to the regulatory numbers by 2019, but we were able to get by the end of the year with all neutralized differences.

Now on page seven, we are going to talk a bit about our numbers of the commercialization company. I think the highlight here is the growing results that we've had in recent quarters. For eight quarters in a row, we've had grown the results, in term of EBITDA in the commercialization. And again, this integration that we had in generation of commercialization is evident in terms of risk coverage and the activities of the commercialization company. I would say that is certainly highlight for the quarter much beyond the market expectation, and we expect it to continue like this until the end of the year.

For services, we still have a small dimension in terms of economic impact, but again, with exponential growth, in terms of our services, the beginning of this activity in the Group. And those slides on page seven, you see an image of a solar plant that was built in Minas Gerais basically to meet the needs of our largest customer. This plant have 8.3 megawatts peak, one of the largest in the country and naturally this is a sign of the proposal and the investments that we are making in this investment. We are still regulating, how the client is going to be supplied from the panels from this mill.

So we are going to page eight, just to let you know about the advances in transmission. As you know, in transmission, have five plant contracted a CapEx of BRL3.1 billion for the coming year. We have one line that is more advanced in Espirito Santo's with approximately 80% of completed work, leveraging of 92%. So again, the differential that we wanted to have in this transmission line. And also, a significant note for us of lot 21, but that has had a leverage of 99.8% with funds -- for the financing started in a much better way that we had expected in our business, and therefore we had communicated, as you mentioned, we would have a profitability in this lot between 12 percentage points and 14 percentage points, in terms of equity profitability, real profitability, and indeed with a leverage of 100%. This metric doesn't make any more sense. But if you look at dividends and equities, this project naturally excelled a lot our initial assumptions basically what we

considered when we participated in the auction. So again, this is a very good sign of how the company is trying after the commitments it took in the auction anticipating conditions with CapEx, with funding and with that you can maximize value for shareholders.

And then here, you have two other projects that are mentioned. They are the three lines that are in the due procedures, and as they advance, we are going to communicate to the market, but the highlight is certainly to Santa Catarina lot 21, which we have completed basically the leverage.

With that I'm going to turn to our financial results.

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

Well, good morning everyone. We're going to start with slide number nine, to give you a bit of the highlight of our financial results. Overall, I think that -- that shows the good results that we had in the company, as a whole. Gross margin in the quarter, we had an increase of 15.1% compared to the last quarter. Year-to-date, we continue with the positive curve that we have had.

The highlights that we are going to go -- we'll see in more details is Pecem. We have the mitigation of losses that Miguel mentioned. We had more 520 million of the GSF impact that was mitigated because of the hydrologic risk management. In distribution, we had a financial gain, would highlight, through the control of losses. And talking about cost discipline, we earned it because 3% below the last quarter, and also indebtedness almost 3 percentage points below last year.

As for net income, we were able to show a net income more than that of the third quarter '17 -- 2017. As for indebtedness, are going to talk about our strategy of indebtedness in our transmission companies, and also a more aggregated views, and I'm going -- going to give you a little more detail about that. And CapEx, this year, we have a year-to-date CapEx of close to 750 million, a lot superior from that of the year of '17. And again, we continue with our investments of -- so close to BRL1 billion excluding acquisitions.

So now if we go to slide number 10 talking a bit about cost controls and ZBB. Remember that our Base-Zero Budget that started in 2015, '16 and '17 continued to go on and we kept -- so, it's all together more than 200 million in gains with all these initiatives. And more recently, we introduced new technologies, we automated processes, we have 100% of our administration centers that are automated in our structure, and the idea is really to optimize our management and our processes. So all this led us to a gain of 1% compared to last year of 814 last year to 804. And remember that we had BRL12 million that are capitalized this year, that were not capitalized this year. If we were to just consider this amount, we will still be in line with what happened last year. So we're really capturing gains here.

And talking about default rates and provision for doubtful credits. We see an increase of this amount, in the case of Sao Paulo, and a slight drop in Espirito Santo. But remember in this period when we compare with the same period last year, we had an increase of

FINAL

tariffs. So it's important to reach [ph] this number, as a percentage of the revenues and not only in absolute values. And we saw in distribution companies, a relative drop of this number. So this number in Sao Paulo went from 0.9% last year to 0.7% this year and in Espirito Santo 1.1% to 1%. So it's just one of the areas in which our analytics BI has had the most impact by addressing customers and the customization that we have, the disconnections, the prioritization that is quite robust today based on analytics, and it is an area that the company is paying very close attention to, and we've had very good results with that.

On slide 12, we have our EBITDA. You see that in the quarter, we had an increase of 23%. Here, you have a view of the third quarter and also of the nine months. You'll see generation and commercialization with integrated management, as we mentioned, which gave us a gain of 40 million, 44 in the commercialization company and Pecem. See, we have in Pecem a gain of 150 million compared to the last year. And all the initiatives that we have been doing that and for 2019, the penalty that is going to be below the availability for 2019 is going to be completely zero because the calculation is done until August and with the information up to August, this number is going to be zero in 2019.

In Pecem, We also have another topic that is very important, which is the core logistics. In core logistics, we had very important investments in the transportation belt, which led to a drop of more than BRL30 million in the cost for the transportation of coal, and we have to pay for penalties because of delays in download. So again, we are much better. We are moving on to zero this cost, but still a reduction of 30 million compared to last year.

Distribution two highlights. We have again losses of BRL28 million compared to last year, 23 million in Espirito Santo and 5 million in Sao Paulo. As Miguel mentioned, we have been 14 quarter in a row decreasing non-technical losses in the state of Espirito Santo. So quite consistent results. quite consistent reduction that have been captured financially.

In terms of market, we had a gain of 27 million year-to-date that are added to the effect with a gain of BRL55 million. And now [ph], there is an (inaudible). But we had an effect of the sale of Costa Rica that was accounted for with a gain of 34 million year-to-date.

On slide 12, we talk about our net income. So, again because of our provisional profitability and financial gains compared to last year, we had profit 80% above the last year, year-to-date. So our financial results, as we mentioned, we had the gain of BRL64 million with the registration of gain of the acquisition of CELESC in the accounting, so it was an advantage purpose. And other than that we have been captured the gains from the losses of interest loss -- taxes. In terms of taxes, we have about 30%. The last year the ratio was 33%. So we have a higher rate in Pecem same for our mix of profits and Pecem has a lower interest rate. And remember that in the last quarter, we are going to have the capture of the gains of -- with the payout of interest on capital. Remember that interest on capital is always accounted for in the last quarter.

On slide 13, we talk a bit about our indebtedness. To your left upper corner, you see the gross debt of the holding as a whole, you see that since December 15, we have been reducing the holding indebtedness and having tax efficiency in the Dutch [ph] because of

Bloomberg Transcript

FINAL

the allocation of our operation companies instead of the holding. And also, we see the evolution of the costs that was at 13%, 14%, now in the last quarter 8.8%. So we are capturing these results in terms of decrease of costs. And in terms of leverage, we're keeping a leverage of about 2 times net debt to EBITDA ratio. In the bottom chart, you see that we include also the companies that are like Sao Manoel, Cachoeira, do Jari et cetera that are part of the holding. And we would be -- with a comfortable level of indebtedness of about 2.3 times, which will enable us to meet all our commitments with comfort.

On slide 14, we focus the issuances of our debentures and our financial structure. Remember that our strategy is to have a diversification of a new structure working with the capitals market, also not impacting our development of course, but working with the banks like the BNDES or BNB in Maranhao, but we also had issuances in the market as a whole.

Lot 24 in Espirito Santo, we have almost 80% of the work completed and we were able to have leverage of 92%. We are going -- this week, we have the issuance of infrastructure debentures that will enable us to have a leverage of 99.8%, remember that we have the right debt. The company is subject to normal taxes and it's very important to talk about cost post taxes. And the cost post taxes is IPCA plus 3.34 [ph], which enables us to have a gain in the project in the end and a capture that is very relevant for the Group.

Going to slide number 15, and just to conclude. We have here the strategy for capital recycling, we're talking about. Remember that in operation terms, we already announced for some time that we would focus on plants that have a capacity above 100 megawatts or between 100 megas and 1 gigas, and with that we sold in 2016, Pantanal Energetica. Very recently, we had the sale of Costa Rica that was highlight in this quarter. And then, we have already announced in October the sale, that is going to be subject to the approval of ANEEL and CADE that of the plants of the small hydroelectical plants and Santa Fe. Again, all together, they have an installed capacity of 131 megawatts. And remember that we're in our strategy of capital recycling, Costa Rica was very relevant and it helps us in all the investments that we are to make in the future.

Well, with that we are going to conclude our presentation, and we are going to open for your questions.

Questions And Answers

Operator

Ladies and gentlemen, we'll now start the Q&A. (Operator Instructions) We would like to let you know that any questions in English are going to be answered in Portuguese and simultaneously translated into English. The first question comes from Andre Sampaio from Santander.

Q - Andre Sampaio {BIO 19422379 <GO>}

Well, good afternoon. I would like to ask a question about your growth strategy. The results are very clear. But I would like to know if you could give us a bit more color about what you're going to do from now on. With the sales of the PCH and advances in transmission, what would be the next step for the company in terms of growth strategy. Do you wish to continue invest in transmission or can we see anything different for the near future?

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

Hi, Andre, good morning. Thanks for your question. I think that we have been very assertive in our strategies. Of course that -- with the capital recycling based on the sale of the PCH get the signs that we have the possibility of reusing this result, as I would say, in three main areas, an increase in distribution, as we saw there is organic growth that enables to continue to have the organic reinforcement of investments. We want to continue to that.

Inorganic growth was better [ph] 19.6% the purchase of CELESC. I think this is a first step in this inorganic growth in distribution, and then we have organic growth in transmission. We intend to obviously in the next auctions to continue to see into investment opportunities, particularly in regions, in which the company already has established investment that is where we have more expertise in terms of knowledge of the market and of the institutions. So transmission will clearly be one of the areas, in which we want to continue to focus on. And then there is an area, in which we are making investment, it has a smaller dimension in terms of energy services. You saw that in this presentation that we are engaging our efforts to work with services. And this is an area that we believe can have exponential growth and has a profile that we believe is quite interesting. And we are always going to be paying attention to opportunities.

Transactions that can be more of an opportunity and that will depend on the analysis of the company case by cases in terms of opportunities that will come up in the market. So I would say this was the strategy of three very important focus, distribution, transmission, services. And then a view that can be just watching for opportunities that come up in the market, in other segments that maybe appealing and available.

Q - Andre Sampaio {BIO 19422379 <GO>}

Okay. It's clear. I have an additional question. Should you have any contact with the -- the new administration, in terms of CELESC. Do you think that it could have any relevant change that could have an impact on the company?

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

We're preparing an institutional agenda obviously to introduce ourselves to the new leadership that are going to take over the government of (inaudible) and also in other states, in which the company operates. We're putting together until the end of the year this strategy in terms of institutional relations, and obviously we're going to clarify what the visions of each one of the government are going to be with regard to assets and opportunities that can be used in those regions.

So to answer you more directly, we haven't contacted any of the new administration yet, the new Governor of Santa Catarina. But we -- in the next months we want to contact the new government, not only Santa Catarina, but in the rest of the countries also to contact our elect new -- elected governors, the ones that are new, to understand what this strategy is going to be for each one of these regions.

Q - Andre Sampaio {BIO 19422379 <GO>}

Okay. Thank you very much for your answers.

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

You're welcome.

Operator

(Operator Instructions) Our next question comes from Carolina Carneiro from Credit Suisse.

Q - Carolina Carneiro

Hello. Thanks for the call. I don't know, if you have already a view in terms of approvals of TL [ph] effects. There is a specific amendment now that will introduce a way to settle the discussion of GSF in Brazil. I would like you to talk a bit -- this a bit. Do you think this TL could be voted this year (inaudible) those amendment could be voted this year to put an end to the discussion or if you think the discussion is going to be for next year. On the side of Energias do Brasil, we believe this is not such relevant because you already worked with the agreement of the GSF. But I would like you just to comment a little about what impacts you expect from the end of injection and this possible resolution for companies in terms of GSF [ph] CELESC?

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

Hello, good morning for the question. Donato Filho is here with us in this call, and I'm going to turn the call for him -- for him to clarify the answer.

A - Donato Da Silva Filho {BIO 17701086 <GO>}

Hi, Carol. This is the Donato speaking. Thanks for your question. This amendment the TL bill is something that people still had questions about this could go straight to the Senate or if it would have to be voted before in the House of Representatives that will depend on the votes of the Senate.

But basically, what does it say about GSF? It's just basically the same text that was in the previous bill 77 that was voted last week and was not approved. In terms of GSF, what's said is that established by law that MRE is just for hydrological risks. So all the effects of thermal dispatch, anticipation of physical guarantees of structuring process, these effects would be removed from GSF retroactively. And this retroaction give an impact if you clear all the impact of effects that are not hydrological companies. To offset, these effects

would have an extension of concession, and this agreement will be made. And then for the concessions to be extended, all the lawsuits would be dropped there.

The accrued amounts today in the last settlement was 8 billion. One of the lawsuits is BRL6 million, but the idea would be to put an end to disputes and normalize operations. We are monitoring both bill. So if the Senators are going to vote it or not and then to see if it's going to be approved until the end of the year. If that will go to the plenary, well then it is a bit more uncertain. But we are expecting for some thing to happen that are going to be beneficial. But anyway, the Senators are going to come up with a conclusion today.

Operator

Okay. (Operator Instructions) Since there are no further questions, the conference call of the results of the third quarter 2018 for EDP Energias do Brasil is now closed. All questions taken on the webcast are going to be later on answered by our IR team. We thank you very much for your attending, and wish you a good afternoon. Thank you very much.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.