

Q1 2017 Earnings Call

Company Participants

- Carlos Freitas, Chief Financial Officer and Investor Relations Officer

Other Participants

- Thiago Silva, Analyst
- Unidentified Participant

Presentation

Operator

Good morning. This is the conference call of Engie Brasil Energia to announce the financials of the First Quarter of 2017. All participants will be connected in listen-only mode during the company's presentation and then we are going to open the questions-and-answers session when instructions for you to participate will be provided. (Operator Instructions)

This conference call will be recorded.

The presentation along with slide deck will be simultaneously transmitted on Internet at the website www.ENGIEenergia.com.br Investors section. There you will be able to find the slide deck and a copy of the company's press release.

Before clarifying, statements made during this conference call relative to the company's business prospects should be seen as forecast depending on the economic conditions of the country, on the performance and regulation of the electric industry in addition to other variables, and therefore, they are subject to changes.

Today with us we have Mr. Carlos Freitas, CFO and IRO; and Mr. Rafael Bosio, Investor Relations Manager who are going to announce the results of Engie Energia and its performance during the first quarter of 2017. Afterwards you may ask the questions that you want and they will be available to answer. Journalist may ask questions by email, please send to the company's press services.

Now I would like to turn the floor to Mr. Freitas. Please, Mr. Freitas, you may start.

Carlos Freitas {BIO 15364136 <GO>}

Thank you very much, operator. It's a pleasure to be with you here in this conference call. And I am assuming that you all have the materials that we made available to you last

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night, so we should start with our presentation, our slide deck on page number four with the highlights of the quarter.

So the first thing to mention is the performance of energy sales which is considerable and it had been basically the same as last year in spite of a slight increase in the average price of 1.4% and we have had a reduction in the volume of the energy sold of 0.9%. And so we are starting with a 1.4 price increase and this is related to the sale of energy to free and regulated customers. So it's important to mention in the free energy market we used to have a high basis last year and the energy contract that we closed last year to improve by high spot prices in 2014 and 2015. And which matured last year, so the comparison basis was high. This is an example.

If you look at the material information, the earnings release for two years ago, you're going to see that there was an increase and it was 16% in average sale prices. So the contracts that we have today in our financials for the first quarter of '17 at normal prices, so the comparison basis was slightly inflated because of the influence of high spot prices in 2014 and 2015 with the drop in consumption of 0.9 is still the effect of the economic crisis, which we have been going through over the past two years and has now started to dissipate.

You're seeing a better performance of the Brazilian economy this year, the performance which is still very much influenced by the agri business and with the manufacturing industry is slightly lagging behind, but this has not yet been enough to, first, to have a growth in sales, there was a quite reduction in sales. We're not really concerned about that and for the rest of the year, we are hoping to have a better sales performance as we will activate as the economy picks up.

Another important thing to be mentioned on this page is the improvement both in EBIT and EBITDA of the company of 15.2% and 11.7%. The main factor here was the better short-term results by BRL60 million. So our performance was less than 50 million last year, and the first quarter of this year, it was positive by about 10 million, so our contribution of BRL60 million in this quarter basically because of the performance of the energy industry as a whole, especially in terms of secondary energy. Last year, the GSF of the quarter was at 12% more or less with a deficit of 12% now in the first half -- quarter of this year.

In allocation, there was a strategy that best generated secondary energy in the quarter, meaning that the market as a whole have allocated less energy in the first quarter and more energy along the year everyone and ourselves included an increase in spot prices along the year. So the industry as a whole has strongly allocated a new energy in the first quarter which led to secondary energy that is almost artificial because rainfall was not wonderful, but it generated a secondary effect of 9.5%. So the secondary energy more than offset the fact that we were short on the buy-side electricity. So the difference quarter-on-quarter explains the variation in EBIT and EBITDA that you can see on this chart.

Moreover, there was also a reduction in fuel because last year we still had a call grant and we generated some energy in the gas plants that was not dispatched, so there has been

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a reduction in fuel, also a reduction in the cost of royalties, not just because of less hydro generation this quarter, which is true but also because of the reduction in the tariff that -- on the fees that we paid for the royalty.

And the reduction of cost as a whole, also including personnel which improved our margins and a better performance of the present quarter. Net income was even better, with a 30% increase in the net income this quarter, not just due to the reasons that I have already explained for the EBITDA, but an important effect, a reduction of 44 million in the financial result as a whole in the company in spite of the non-recurring factors both last year and this year, but if you want to focus on what is recurring, there has been a significant reduction in the cost of debt, because part of debt is IPCA and IPCA has dropped. This is also an important factor here, which is monetary correction of our payments for concessions. So all of this has led to a drop of 44 million in the financial result in the quarter, which helps to explain the better performance of 30% in our net income.

The net debt has gone up slightly. So the gross debt have gone up to almost BRL200 [ph] million and the main reason for that was the withdrawal this quarter of 220 million, an amount that we withdrew from BNDES for Santa Monica that is already in operation. So, the drop in generation I have explained was a 16% in hydro generation, because of worst hydrology this quarter for the reasons that I have already mentioned.

Another important point on the last line was the reduction of our headcount, about 7% drop in headcount, especially because of the voluntary dismissal plan that we implemented that we started in November of last year, so quarter-on-quarter there has been a significant reduction in the company's headcount.

On page five, you can see non-financial highlights. The first point here is the confirmation by Fitch of our National Rating, Long Term is at AAA, and the global scale at BB+, which is still very much above sovereign rating, because the companies that operate in Brazil having a rate above sovereign is a major accomplishment that we should celebrate.

Another important point on the right-hand side of the slide. Santa Monica Complex is now fully operational and it reached total capacity in April 2017. The company also approved a payout of dividend, complementary dividend totaling 100% of the adjusted net income of last year, BRL2.28 per share and this amount of dividend will be paid soon.

On the next page, so we have completed the modernization work of Salto Santiago. It was a four-year project to modernize the power plant to extend its lifecycle, which is important for the company. It also increased slightly the assured energy of this power plant and this has been important to keep the stability of our performance.

We are also proud to say that the largest power plant completed its issuance cycle of Carbon Emissions Reduction Certificate of the United Nations. We were one of the first ones to have it here in Brazil. Ten years ago we started this. And in terms of sustainability, we are also proud to say that we have a project that has been approved by ANEEL for

electrical chemical battery. And now we are looking into new technologies that will help to evolve according to the market.

Now in the next slide we show how much our company has grown. There has been an increase of 60MW more or less which was through the farms of Santa Monica complex that has become operational.

On page nine, we are part of the largest group in Brazil, the largest independent power generation group. And we are building other power plants, which will add about 700MW.

On page 10, it is important to mention here quite a few things. First, this year you can see here an increase, a significant increase in the share of free customers, basically due to a large regulated contract that expired last year, 300 average megawatt which was replaced in the free market. But we are likely to go back to a fixed position between fixed and free market because in 2017 the Campo Largo PPA will go in effect, as well as Pampa and we will again have a significant share or more significant share in a distribution market.

It's also important to remember that this increase in the green bar was trading we do through the operation that we believe are conventional energy and we received incentivized energy with the old target and we can also sell to more customers energy with smaller volumes to gain margins. This is the strategy that we have been using to lower the threshold of the volume sold to customers to have a broader customer base and then we can do more energy trading. And this is shown on page 11 in our diversified portfolio, including free customers portfolio we have zero default for customers.

Now on slide 13, this slide layout is slightly different to reinforce the message that today we have excess assured energy in the short-term, but there is -- so we have energy available which may be a theoretical availability, because there is an over-estimation of projects that might not be built. But the fact is that considering what we have today, but lesser power plants in the country considering the rainfall deficit we have, higher volatility in spot prices. So in spot prices, if you look at the last four weeks, it has varied greatly, really [ph] amazing, great variation.

So the system is sensitive to any change in parameter in rainfall. And for this reason, we are setting aside a larger share of uncontracted energy this year, next year too. So we have about 10% energy, on page 15, 9.6% of energy for potential sale, but it is not so. And we do not might need to change this number very much during this year, it might change a little bit, but if we are to sell more energy, it's because we have decided to do so. We think that this volume of 9.6% of energy available for sale, but not sold in the reasonable level for us to face the uncertainties with regards to GSF, spot prices and also considering that we have a GSF issuance for the share sold to regulated customers, it's important to remember this.

Today in 2017, we have partial (inaudible) for regulated customers and today in 2017 we have also free customers. Thus we are -- why we are trying to still have a share of uncontracted energy or unsold energy is a buffer security margin. And today considering the high spot prices, and we expected high spot prices for next year, we use a strategy

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and we are -- because we are expecting an increase in average prices in the energy market. We used to see, for example, that for next year a few months ago energy was below BRL200, today it's BRL220, so energy to be delivered next year. So for this year spot price it was very high, and risen above BRL300 and the near-term market is going back to a more normal level.

And we are expecting prices to normalize in the long-term and this is very much influenced by the mid-term spot prices, which is very high this year, and it was high last year. And we are expecting that next year they will be slightly higher than they were last year, but still lower than this year.

So all of this is translated in sales strategy that we execute and we sell more when we think that prices are better for us to sell and when we think there's more margin.

Now on page 17, which is just an overall status. You already know Jirau is already in operation since last year it is generating according to expected, generation is quite efficient and we are in fact waiting for the beginning of the project. We hope that this project starts this year. We do not yet have an estimated date, but we hope that it starts effectively soon and it's not definitely going to be to end this year, because it's really long and it will certainly require the approval of ANEEL, CATV [ph] and BNDES, but we hope it will start in a few months, and then we will be able to assess in the committee how this asset could be included into the company's portfolio.

Now, talking about assets that are already in our assets, pages 17 to 23, first, Pampa Sul is interesting, its work on the site is 55% complete and the filling of the reservoir has begun, it's a reservoir to keep water for the power plant. And so the cables -- and the stringing of cables at 49 of the 51 transmission line towers are complete.

We can say the same about Campo Largo phase I on page 20. This is the company's largest wind project today, have today sold -- with energy being sold both in the free and regulated markets. So most of the distributions, installations are ready near completing the generation so that this project is in Bahia and its evolving as scheduled and as projected, and it will go live next year -- towards the end of the next year.

The Assu V Photovoltaic Central in Rio Grande do Norte. The company's first centralized solar energy project sold to the Regulated Market. Work on the site started on March 2017 and is scheduled to and/or to be complete by the end of the next year. So our intention is to complete this construction by the end of the year.

And lastly on page 22, our debut in the incipient market of decentralized solar energy generation, the project in Santa Catarina, where there was a demand for residential solar panels that was 11 times greater than the originally estimated. So we started the first major step that was the most relevant in this segment.

And lastly on page 23, our pipeline of projects that will be treated depending on the market. There are some projects that are being prepared. We always (inaudible) them sort of ready so soon as the market demands, both the regulated and free markets. So

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we have Santa Monica, Pampa, solar energy, wind energy and natural gas power plants, and they will be deactivated whenever we see good opportunity.

So talking more about the financial performance on page 25, you can see our flat performance in terms of revenue, but with significant improvement in EBITDA, net income over the quarters, which have been consistent along the year.

So going into more detail about each one of the impact on page 26, so there has been an increase in average sales prices and a reduction in sales volumes, back almost BRL80 million. So the sales increase took place because of short-term, so the players were reallocated in the first quarter of the year, thereby creating this artificial surplus of secondary energy.

So, in spite of us being short in terms of allocated energy, we had the benefit of BRL16 million in our revenue because of ST trading at the SBT [ph]. So we had GSF in the first quarter last year and 9.5 in terms of secondary energy in the first quarter of this year. The reduction in fuels of 24 million, and once again, not just because of a reduction in energy, but also because of a reduction in royalty fees to be paid and that's why we have a better performance of our EBITDA.

On the next page, the financial result of 77 million better than last year and this is explained by the reduction in the cost of debt, reduction in monetary correction and also because of our investments in equity in Campo Largo and Pampa, and for this reason we have a smaller financial income, offset by more income tax. That's why we have higher provisions on the income tax.

On page 29, here you can see a slight increase in our net debt, most of which because of BNDES to Santa Monica. In terms of cash, similar level as December last year with a slight increase in the net debt. The net debt which is still low of 0.4 times our EBITDA, so we still have a lot of room to improve this to become more efficient in our balance sheet. And we are going to make it more efficient through growth, growth in transmission, for example, because there has been a transmission auction just last Monday, unfortunately we could not win any lot but at the end it was a very good practice.

We were competitive, for example, lot one, we went to the live auction contending with the winner and we lost it by very little. So this was a very -- participation, because finally we bid in an auction and we almost got there, so we learned how to do it and whenever possible, we will participate in the future, in future transmission auctions. I don't think we will be able to do that.

So we are really considering our entry in end transmission. We may also consider M&A with the projects at Jirau and (inaudible) is also going to increase along this year, because all our CapEx for this year will be funded by debt. Also on page 30, it's important to mention that the payment of dividends in our investment were almost all funded in the third quarter with operational cash flow. So only about 200 million were through the withdrawal from BNDES as I mentioned before.

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On page 31, the highlight in the reduction on the face value of the debt was 11.2% last year and today it is at 10.1%. We achieved that more than two-thirds with BNDES and with a quite small profile.

So on page 32, as I said before, we already contracted CapEx for 2017 for investments in Pampa, Campo Largo and Assu, and the one that was missing for Santa Monica will be funded by debt at a level of the project. So here there is a 2 billion growth, so the debt today is at 3.300 billion more or less, will get to 5.300 billion by the end of the year. So gradually we are going to improve the efficiency of our balance sheet, but we still have room to increase our leverage even more through growth in M&A or both in generation and distribution.

Lastly on page 33, we paid 100% of our dividends, because of the economic crisis, we were paying less. We tried to hold some cash, but now, as we have leveraged capacity in company, we are paying 100% for 2016 again. So our commitment is to have as a minimum payout 50% of the net income and to always pay more whenever possible. So when we have more CapEx, we might reduce if it's more difficult to finance the CapEx now, as we can do it, we are going to pay the dividend. Let see what the future has for us, but we have leverage capacity to improve the company's financials.

So, this was all I had to say. Now, I would like to open for questions.

Questions And Answers

Operator

We are now going to start our questions-and-answers session. (Operator Instructions) Our first question comes from (inaudible) from Safra Bank. Please, (inaudible) you may start.

Q - Unidentified Participant

Thank you all very much for the call. I would like to understand your strategy in the auction. You said you were bidding in one. I would like to know your assumption, was it a CapEx deduction? So you told me that you went all the way to the live auction. Could you give us more detail?

A - Carlos Freitas {BIO 15364136 <GO>}

We looked at some lots and we bid in some of them.

Q - Unidentified Participant

And which lots?

A - Carlos Freitas {BIO 15364136 <GO>}

We and other players we have assumptions regarding the real CapEx of the work, construction time, the environmental deadlines too, so we make each -- we make our assumption. We target some lots and the largest one we bid in was the first one. So the

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first one is offered for one of the closed lots. And in the auction, if there was a difference of 5% between the best offer and the next one, you could bid in the live auction and we did.

We made an offer for a closed lot with another player, another bidding at the end. We were disputing or fighting in the live auction and it went down gradually million by million and we did for few rounds. We went all the way to our limit, the limit that we considered reasonable, we got there. So each one, each need to make their own choices and we used a few assumptions in terms of CapEx reduction and with regards to construction schedules, but someone made different assumptions. We have our own logic according to what we thought was reasonable. We went all the way to our limit, but each company is free to make its own assumptions.

We wanted to go all the way to the reasonable limit in order to add value. We didn't want to go beyond that limit. We don't want to grow just for the sake of growing. We want to grow with margin. So we thought what was reasonable in terms of CapEx and timing.

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions) Our next question comes from Mr. Thiago Silva from Banco Santander. Please, Mr. Silva, you may start.

Q - Thiago Silva {BIO 20990813 <GO>}

Thank you very much for the conference call. About Jirau, I know you said that you are going to make a trend for this year. Could you give us an overview or an outlook in terms of how this transfer is going to take place in terms of the balance sheet?

A - Carlos Freitas {BIO 15364136 <GO>}

Thank you for the question. But for now, I can't say anything to you. I cannot disclose anything. This is going to be analyzed in the committee of related parties with your news to conduct a very intelligent analysis about the pros and cons of each alternative. There are alternative that will clearly increase the company's leverage, there might be a combination of that with action. So as a reminder, in a cash that was a debt and now when you sell a small asset, part of it will be in cash now and part will be later. All of this is going to be assessed and everything will be assessed for us in the committee, and again the committee is going to led by independent members and we are going to view the pros and cons of each alternative. But for the time being, I can't say anything. All I can say is that we have room to increase the company's leverage, and this is not new. We can improve the efficiency of our balance sheet, but with regard to Jirau, I can't disclose much more yet.

Q - Thiago Silva {BIO 20990813 <GO>}

Thank you very much.

Operator

(Operator Instructions) We will now end our Q&A session. I would like to turn the conference over to Mr. Freitas for his closing remarks.

A - Carlos Freitas {BIO 15364136 <GO>}

Thank you all very much for your presence today. If you have any other questions or comments, we are available to answer on e-mail or over the telephone. Thank you very much and have a good day.

Operator

The conference call of ENGIE Brasil Energia has now ended. We thank you all for your participation and have a good day. Thank you very much for using Voitel.

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