

Q3 2019 Earnings Call

Company Participants

- Jose Aloise Ragone Filho, Business Development Officer & Member of Executive Board
- Marcus Pereira Aucelio, Chief Financial Officer, Investor Relations Officer & Member of Executive Board
- Raul Lycurgo Leite, Chief Executive Officer, Chief Legal & Regulatory Officer and Member of Executive Board

Other Participants

- Caio Yamate
- Carolina Carneiro
- Thiago Silva

Presentation

Operator

Ladies and gentlemen, thank you for waiting. And welcome to Taesa Conference Call. We would like to inform you that all participants will be in a listen-only mode during the company's presentation.

After the company's remarks, there will be a question-and-answer session when further instructions will be given. (Operator Instructions).

Now, I would like to turn over to Raul Lycurgo Leite, Taesa's CEO. Please Mr. Leite, you may proceed.

Raul Lycurgo Leite {BIO 19066621 <GO>}

Good morning, everyone. We'd like to thank you all for participating in this conference call to announce the results of quarter three 2019. Here I have with me, Mr. Marcus Aucelio, CFO and IRO; Marco Faria, Technical Director, in addition to our IR team.

Before I start my presentation, I have a few comments to make. We closed another quarter, with consistent and positive results. We had an annual growth and our net income, IFRS, both for the quarter and also for the accumulated in the first nine months of the year. With this, we continue our policy of maximum distribution of earnings to our shareholders.

FINAL

Yesterday, our Board approved the distribution of dividends and added to all the payments made in 2019; including the payments referring to the fourth quarter of 2018, totaled BRL1.71 per unit of diluted. This represents 6% in the 9-month accumulated amount, considering the closing price of BRL 28.30% on yesterday.

Regarding the regulatory results, this was impacted by the 50% cuts in the RAP, in some categories through concessions as expected and known by all of you. Dr.Marcus will certainly will give you more details about what we have been doing to minimize these cuts. Another highlights is our commitment to the teams if governance environment and social responsibility.

Proof of that was the mission of another green debenture with a time of 25 years, which was completed in October 2019 which reinforces our commitment to the society and all the other stakeholders.

Finally, I'd like to reinforce our focus on sustainable growth, always supported by the pillars of financial discipline, operational efficiency, value generation to our shareholders, seeking to prolong the average term of our concessions and consequently the longevity of our business.

Now, I turn it over to our CFO and IRO, Mr.Marcus Aucilio to present the results of the third quarter. Thank you.

Marcus Pereira Aucelio {BIO 19965152 <GO>}

Thank you, Raul. Good morning, everyone. Let me start by chart number 3, with the highlights of quarter three for the IFRS results. In this quarter, our net income recorded BRL357.8 million, an increase of 21.4% or BRL63.1 million higher in comparison with quarter three 2018.

The main factors explaining this 21.4% increase, we have three factors. First, the increase in the construction margin by virtue of the progress of projects under construction. And also in this quarter, we started to account for the construction margin of three concessions, Novatrans, Miracema and Mariana. And the accounting of these three reinforcements generated an impact of BRL130 million.

Another relevant factor which explains the better net income was the decrease of 22.6% in our net financial expenses due to a higher average volume of cash investments, also greater profitability from investments and also a drop of the IPCA base when compared with quarter three 2018, which is the index of 76% of our growth there.

These two positive effects were partly offset by the BRL88.6 million reduction in the monetary restatement revenue. Since when we compare with quarter three 2018. We have an IGP-M and new a IPCA which were lower than last year. The adjusted net income after deducting the margin, referring to the adoption of CPC 47 of BRL210 million, we had an adjusted net income of BRL614.8 million.

After deducting the BRL\$210 million, we put them into a special reserves without compromising our cash and the company's leverage, since this gain is purely an accounting gain.

After legal and tax incentive reserves, the distributable earnings reached BRL532 millions. As Raul already said, this is equivalent to BRL1.54 per unit, which represents a payout of 86.6%.

Now on slide number 4, here we talk about our regulatory results. In the end of quarter three 2019, the cash balance closed at nearly BRL2.1 million, which represents a drop of 6.3% when compared with the previous quarter due to the payment of earnings to our shareholders. And there was also a period of maturation of interest and amortization of a great part of our this.

The net debt was BRL2.6 million, an increase of 4.9%. This is basically due to a lower cash balance, and our net debt over EBITDA ratio reached 2x, which was a little over what was reported in the previous quarter of 2019. It was 1.8x in quarter two.

Our regulatory net revenues were BRL331.9 million, down 8.4% year-on-year, mainly due to the 50% cuts in the annual submitted revenues or RAP of some of our concessions in the 2019 and 2020 cycle.

As previously known by all of you, you all know the characteristics of heights of concession. The operating costs and expenses totaled BRL56.7 million, an 8.9% increase year-on-year mainly as a result of higher personnel expenses. Our payroll expenses increased by 15.3%, basically due to salary readjustments of our employees due to the collective bargaining agreement. So there was a readjustment of 7.32%, and there's salary increase is based on the same list of inflation industries.

The IPCA and IGP-M, which we adjust our RAP, so the RAP readjustment was the same at that of the collective bargaining agreement. We also have a program of meritocracy, promotions, and talent retention considering that the transmission market is very re-tabulated, so in order to retain our talents, we have this main focus on talent retention program.

We also had the consolidation of Brasnorte. So Brasnorte is now consolidated into our balance and therefore, we saw the effect of the Brasnorte employees, which are now recognized in our company. And we also have some open job positions and we were able to fill those position, some of these positions increasing the number of people working for Taesa.

The regulatory EBITDA totaled R\$275.2 million, 11.3% lower year-on-year, and the EBITDA margin was 82.9%. It's worth noting that even with this drop in our R&D, which had already been projected, this has -- we have been able to achieve maximum distribution of earnings for our shareholders. Our net financial expenses also decreased as explained before in our IFRS results.

FINAL

The availability rate of our transmission lines was 99.88%, and the variable portion was BRL8.3 million, representing a drop of 35.4% year-on-year. Therefore, our PV was only 0.7% in the first nine months, which is lower than the 1% reported in 2018. In respect to our opportunities in the secondary market, we acquired Bipar stake in Brasnorte, a stake of 11.6% and now we hold 100% of Brasnorte's total share.

We also signed an SPA with RC Administracao e Participacoes S.A., for the acquisition of Rialma I. Regarding our construction projects, we have an installation license for ESTE now. We were also granted the installation license for a great part of the Ivai project. So today, we have all the installation licenses for all the substations, we have four standard lines, and we already have the permit for two things.

And also for Sant'Ana, the concession that we acquired in December in the last auction, we signed the agreement in March, and we already have installation licenses for the two substations. We continue to advance in the construction works off the concession for which we already have, installation licenses with some projects now at final stages, approaching their completion and amortization in the coming months.

It's worth mentioning that we have already energized the Miracema Lajeado transmission lines in an extension of 30 kilometers, and this was completed on September 29. We still have the second part to energize in the Miracema construction. And finally, I would also like to highlight the 7th issuance of debentures, where we were able to raise BRL509 million at IPCA plus 4.5% for a term of 25 years and an average duration of 14 years.

As Raul already said this is another green debenture issued by the company is this mission. It was based on the CVM 400 instruction and we were able to put 90% of this volume to individuals more than 4,000 different taxpayer IDs which demonstrates the company's credibility, selling a 25 years debenture mostly to individuals.

On slide number 5, it's important to highlight the macroeconomic impact on our IFRS revenue. This just show the influence of inflation on the distribution of our results. We have a greater exposure in IGP-M because 20 operational concessions are linked to the IGP-M of a total of 27. That's why we have a strong correlation of our revenues with the IGP-M.

And on slide number 5, we can see that when compared with quarter three 2018 and quarter three 2019, we went from an accumulated IGP-M of 3.1% to 0.52%. And for the IPCA, comparing quarter three '18 when we had 1.5%, we went to 0.31% in quarter three 2019.

This decrease in the IGP-M and IPCA indices that we can see on the bottom chart on slide number 5, we went from a monetary restatement revenue of BRL105.7 million to BRL17.2 million this quarter, which represents a drop of BRL88.5 million in this monetary restatement revenue.

Now moving on to slide number 6. Here, I will give you some more details about the drop in our RAP+ and how it impacts our regulatory results. The bottom chart shows the operational RAP. Here we can see that we had an RAP cycle 2018-2019, we had an

operational RAP of BRL2.020 billion. So we had a drop of 50% of the RAP income in some of the concession, representing a drop of BRL291.3 million in our operational RAP.

And on the other hand, we have the inflation readjustment, which added BRL148.4 million, and we also have an additional BRL55.8 million from the recent acquisition that we have already completed.

So basically Brasnorte, Bipar and Transmineiras. And considering the RAP of the companies that will start operating next December, we will have an addition of BRL77.1 million. Therefore quarter 2019-2020 cycle, will have an RAP of BRL2.010 billion which represents a decrease of 0.05%.

And this without considering the acquisition for which we have already signed a contract, however, we still have the precedent conditions which are the four, we have concessions and also Rialma 1 which will allow us to add another BRL115 million to the operational RAP.

Slide number 7. Here we have our projects under construction, and what's important is that Miracema, EDTE and Mariana, we are on the verge of energizing these projects, Miracema we have already energized a part of the project, and we should be completing the project energization within the deadline established by ANEEL. For EDTE and Mariana, we'll also energize the projects in the coming months. For Aimores and Paraguacu, which are two concessions that we have with CTTEP.

We have already recorded some physical advancements of about 43% and 44% respectively. Janaba another 100% Taesa project we are -- we have a 15% physical program. And now we will start working with ESTE, Taesa, and Sant'Ana for which we just got the installation licenses.

So this is the end of this presentation, and we are now available to answer your questions.

Questions And Answers

Operator

(Question And Answer)

Thank you. The floor is now open for questions. (Operator Instructions) The first question is come from Mr.Thiago Silva from Santander Bank. Mr.Thiago, you may proceed.

Q - Thiago Silva {BIO 17655676 <GO>}

Good morning, everyone and thank you for the call. I have two questions. First; about the dividend. As you communicated in your release, according to the CPC 47 accounting and the IFRS rule, you reserve part of your income considering that the dividend distributed on the IFRS rose. And also due to your construction projects. I think that you're holding back the dividends where you could be -- will, I'd just like to understand whether you're going

to change your dividend policy or is your current policy to keep building these reserves for the future and also, regarding your growth, we will have an auction next December. And everything hearing me and then they receive is also relevance today in the nation in the states. So, will you continue to observed in this sense? Is there any obstacle of the (inaudible) controller to prevent or to hold back the growth.

A - Jose Aloise Ragone Filho {BIO 20590608 <GO>}

Good morning, Thiago. Let me answer your first question regarding dividends, and then I will turn it over to Raul and he will talk about the growth. In respect to the way we distribute dividends, what we have been doing is that given the adoption of CPC 47, what's happened is that now during the construction period. We have a construction margin, and this resulted in an increased net income. This construction margin from this new methodology resulted in us having an income now, but without having any cash. And if we were to distribute the result of this construction margin what this company would be doing is go to the market and take some debt to be able to pay for these margins, therefore, what the company decided to do. Is that we will continue to distribute dividends based on the past IFRS. And that is why in our release, we demonstrate how we are taking out of this reserve, the remaining construction margin, which shows that we will continue to have the same payout that we used to adopt in the firm.

So this reserve as soon as, each of the concession start of operating, we will distribute part of these reserves in future results. And this is not to compromise the company's leverage and also not to compromise our future growth. The company have really taken a conservative stand and has always been concerned with our financial discipline. So, this is in line with the companies usually reserved growth will start to be distributed as a concession part operating.

Thiago, thank you for your question. Regarding our goals, I would like to say that we are very well prepared for the December auction. It is somewhat smaller than what we saw in 2017 and 2018 investments of a little over BRL 4 billion and in previous years, each of these auctions were about BRL10 billion, roughly.

So in 2017-18, we have been nearly BRL20 billion in investments. Now in December, we're large --we are serving all of them. So that we can take them to our boards, which are the best laws and the best opportunities. When we look at Taesa's footprint on the map. It encompasses all Brazilian regions and any of these assets may make sense in terms of synergies for Taesa in the future.

We believe that 2020 will be a very busy year in terms of M&A. And, of course, this is a consequence of the latest auctions. In 2017 and '18, there were small and medium developers that want some of the assets; today we have about BRL3.8 billion in the hands of 75 to 78 trainers.

And this is an average of about BRL49 million and BRL50 million for if we calculate directly. And we believe that these players will lift these concessions as soon as the projects are energized. So, we believe that 2020 will be a promising year. We will have two auctions in

2020 that are all already scheduled, one in July, one in December. And we strongly believe in a very busy year, both in terms of issues and balance sheet.

Our growth is always based on responsible work and finish on condition for our growth is to maintain the AAA classification, and three major rating agencies also continuing with our dividend distribution policy growing reponsively with financial discipline and value creation. It's not just growing for the sake of growing. This is not our way of doing things, we will always grow by adding value and creating value to its shareholders. Today, we have room to continue growing as we have been and we will continue to grow always looking for the best opportunities that will bring the company to greatest return.

Q - Thiago Silva {BIO 17655676 <GO>}

Thank you.

Operator

The next question is from Caio Yamate.

Q - Caio Yamate {BIO 19539538 <GO>}

Thank you for answering my question. Could you tell us more about the number of transactions? Is there any expectation in terms of when it's going to be completed? What are the precedent conditions that are not yet being there? And is there any possibility of it not being completed.

A - Jose Aloise Ragone Filho {BIO 20590608 <GO>}

Caio. Thank you for your question. We cannot forget that between April and May. And ANEEL canceled TLP 1, which is one of the main concession that they have. And this is known by everyone, it was even communicated by ANEEL themselves.

They determine that return of 15 months of RAP. Of course, we took the legal measures required and of course this will affect our relationship with the funding bank, which in this case is Caixa Econmica. And there was an injection for the RAP not to be discounted until the final ruling of the administrative decision. And this happened last month, we have the final ruling last month. And the cancellation was maintained, which applies to the 10,15 months of RAP.

Of course, that there is a President condition, which is Caixa Econmica consent, which has not yet been given, probably due to this event which was the return of 15 months of RAP. I think this was the first time in the history of the regulatory agency where they required the return of these many months of RAP.

Of course, we will see some updates by the end of the year, and we believe that this situation will be solved before the end of the year and that's what we're working on and it's not just (inaudible) and with Caixa Econmica who are financing them.

Q - Caio Yamate {BIO 19539538 <GO>}

Thank you.

Operator

The next question is from Ms.Carolina Carneiro from Credit Suisse.

Q - Carolina Carneiro

Good morning, thank you for the call. I have two questions. First, due to the variable portion, it was a little higher this quarter. You even mentioned, this in your release. So, I'd like to know, if we can expect a normalization of the level next quarters and also you talked about the progress of the physical construction of your project. Could you please talk about Aimores and Paraguacu, you have practically 50% of the work completed and the annual deadline for completion is February 2022. So can we see, maybe expect that these projects will be completed way before the deadline.

A - Raul Lycurgo Leite {BIO 19066621 <GO>}

Good morning, Carolina, with respect to the variable portion, when we compare the quarter three 2018 with quarter three 2019. In 2018, specifically in quarter three, we had a set of reversions. And because we didn't agree with the application of the variable portion and our requests were accepted, that's why we had a reversion.

And in quarter three 2018. We had a positive number. Therefore quarter three, 2019, we have some current performance GE, specific GE equipment and they are showing problems not just for Taesa, but also, generally in the industry. And we detected this problem and what happened this quarter is that we had some explosions of the transformers that were concentrated in this quarter and this ended up having an impact on our PV this quarter.

However, if we look at the results for the year, the numbers are lower than those of last year.

And since we are aware with these problematic pieces of equipment, we previously ordered new transformers, so that we can change the ones that are defective and we have already changed some of them. And we are now moving onto change all of them, all of the defective equipments. And we should not have problems in the future, like we had this quarter.

Your question about Aimors and Paraguau, the licenses were issued early, that's why we were able to cost to well. So we have much physical progress and we are expecting to have these projects energized by the end of next year, which would mean that these two projects will be delivered early. Thank you.

Operator

(Operator Instructions)

A - Jose Aloise Ragone Filho {BIO 20590608 <GO>}

We just received a question via webcast. Gabriel's question is how is the company expecting to take part in the next auction? But I think that this question was already answered by Raul.

Operator

(Operator Instructions) Since there are no further questions, this question-and-answer session is now closed. Now I turn back over to Mr.Raul Lycurgo for his final remarks.

A - Raul Lycurgo Leite {BIO 19066621 <GO>}

Ladies and gentleman, we would like to thank you all for participating in this conference call. If you have further questions, Taesa's and our IR team will be at your service. Thank you very much and have a great day.

Operator

Hi. This conference call is now closed. Thank you all for participating and have a great day.

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.