

## Q2 2019 Earnings Call

### Company Participants

- Andre Luis Nunes de Mello Almeida, Chief Accounting, Tax and Asset Management Officer
- Henrique Manuel Marques Faria Lima Freire, Vice Chief Financial Officer
- Miguel Nuno Simoes Nunes Ferreira Setas, Chief Executive Officer and Investor Relations Officer

### Other Participants

- Andre Sampaio, Analyst
- Maria Carolina Carneiro, Analyst

### Presentation

#### Operator

Good morning. Welcome to EDP Energias do Brasil teleconference. We'll be discussing Q2 results of 2019 and the first half of 2019. All participants are in a listen-only mode. We'll have a Q&A session shortly. Further instructions will be given then. (Operator Instructions) This presentation will be broadcast simultaneously over the Internet at [www.edp.com.br/ri](http://www.edp.com.br/ri). You can have the company's results release.

EDP Energias would like to state that forward-looking statements related to business perspectives such as projections, operational and financial goals as to its growth potential are based on predictions based on the management predictions as to the future of the company. These expectations are dependent upon the economic situation of the country, the performance and the regulation of the energy sectors, among other variables, and therefore are subject to change.

I turn over to Mr. Miguel Setas, CEO and the VP of Investor Relations. You may have the floor now, sir.

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

Thank you. I'd like to welcome everyone to Q2 results teleconference. I'm here with the CFO of the company, Mr. Feire, and other executives available to answer any questions you may have.

I would like to start by giving you some context on Page 2. That's the highlights of the quarters. That's for Q2 and the first half as well. I would like to state that this is a quarter with favorable biological [ph] scenario that, of course, positively impacts our results. The

way we see it, with this integrated management approach, and this is a more favorable scenario, as I said, these, of course, mitigate negative impacts.

Another important highlight has to do with the volume. The volume for energy is above expectations. That impacts positively distribution as well. And there is somewhat a small growth in non-technical losses in the state of Espirito Santo. But we -- distributors, we have managed total loss 0.19 percentage points, 0.1 percentage points in the state of Espirito Santo in terms of total losses year-on-year.

Another highlight is the effort the company has made to invest more in generation and also in transmission. We'll see that in further detail. 29% of our total CapEx has already been executed, an improvement across the board. We are at 39% of our CapEx revised, which is significant. This was a quarter in which we announced the purchase of yet another lot, BRL415 million added to the CapEx. It's BRL3.8 billion in transmission. And significant improvements which I'll further detail for both investments and financing our credit lines we have acquired as well and the major changes, the pace in which we are executing our construction works. We can foresee that these undertakings will be concluded ahead of schedule.

Overall, in terms of costs and financial position, our focus has been in cost control. When you compare OpEx and gross margin, this is a measurement of our operational efficiency. It's below 29% in this quarter, which is very significant to us. Let me also state our balance sheet is very healthy indeed, which gives us an indication of growth.

Having said that, I think we should dive deep into the detailed presentation. On Slide 3, you have market numbers. As you can see, on Slide 3, 6.8% growth in volumes in the state of Espirito Santo, and that's year-to-date. That can be translated into favorable results for distribution.

When we look at losses at the bottom, on the Slide 3, we compare equal periods, Q2 of '18, Q2 of '19. This will neutralize seasonality effects, a 0.19% loss and 0.10% in Sao Paulo and Espirito Santo, respectively, a small or a minor increase in non-technical losses because of the volumes in the state of Sao Paulo and Espirito Santo.

Our expectations going forward is to keep on focusing on this effort, a very controlled losses close to the regulatory limits. Our goal is to be close to those benchmarks.

Moving on to Page 4. We've seen, in the recently announced reports, the energy management impact. This is how we manage energy.

On Slide 4, '17 and '18 were years in which hydrological scenario were not very positive. If we hadn't implemented a mitigation strategy, we would have a margin loss, BRL718 million in 2017. This is not what happened. As we all know, we adopted a very aggressive strategy, and a very complete one at that, to mitigate the risk. So, '18 and 2017, the hydrological risk was completely mitigated in 2017, not only by what we hired. We interpret this value chain as a single one.

FINAL

Moving on to the first half of 2019. That will help us understand our results. We must understand that -- in which the hydrological risk is lower and GSFs are going up, it becomes an upside then, the mitigators that we have hired can work as a limiter. The upside would be reduced to BRL73 million, part of the hedge -- because of the hedge. And another part comes from our seasonal guarantees -- or physical guarantees rather. This is shown on your top right chart. The green line has more energy allocation from physical warranties.

This is a year in which the hydrological risk is unlike previous years. And again, mitigators will operate as a reducer of that risk. We have BRL25 million from the EDP commercialization. This is to protect risk. We all know what happened in the free float market.

At year's end, a couple of companies did not operate given the financial constraints there. So, we have been conservative in our risk mitigation approach. As you can see, we reduced the free energy or traded energy in the free market. This is the -- this is to explain why BRL25 million is lower than what we had in previous years, in the two previous years.

And there's something else, of course, in this scenario. We have been very conservative as to the counterparts. A benign hydrological scenario can give us opportunities to generate value with consumers.

But when you look at what we have and what was contracted out and gross margin, we have 50 more million -- or BRL50 million more than the energy that we contracted out. This is unlike we had in previous years. This management gives us the constructive approach as to the whole scenario. If you need further detail in interpreting, that data will be available during the Q&A session.

Let's move on to Page 5. This is the CapEx evolution. This is just proof of what I said at the beginning. We had a 29% CapEx reduction. In Q2, we had 75% of the CapEx above what we had in Q1. We are concluding our construction projects. It's almost a third when compared to projects we had in previous years. This new lot, Lot Q with the Santa Catarina Lines and Rio Grande do Sul, two concessions in Southern Brazil, that made sense. That made complete sense because we had better profitability margins than those we had in the auctions or the three auctions we didn't [ph] contracted transmission at all.

We had 10%, 11%. Now, we have a project that have profitability above 12%, and that's leveraged, which is a consistent move on our part to maintain the profitability levels we've had and even going above recent auctions. As you know, we had lower profitability rates in recent auctions. That's why we didn't hire any project at all. We have one-third of that CapEx in the lots that had been contracted and concluded previously. The highlights, we have the LEs [ph] of all these projects. Lot 18, we has a previous license issue and Lot 21 is partially licensed. We're still waiting for the license to conclude that line.

As to investments, everything has been addressed. We have to conclude the financial plan for Lot 18 and the Lot Q later in the semester. So, the message is one of tranquility, if I may. Some projects are more advanced than others, but we are comfortable with the conclusion of these projects.

Let's move on to the quarter numbers.

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

Good morning, everyone. This is on Slide 6. This is the EBITDA. When we compare this quarter to the same quarter in 2018, we are down 6.8%. We have to remove the small power plants that were sold in 2018, so they did not contribute to these numbers. And the non-cash effects, we had a lot of concentration in the second semester of 2018. We had about BRL62 million, which is non-recurring for this year.

This is the adjusted EBITDA. Had a growth of about 12% when compared to Q2 2018.

Let me point out the hydro generation. This energy boost for the second semester showed that reduction of BRL53 million in our power shifting that will impact hydro generation.

As to Pecem, the upside, we have the ancillary services' new regulation where you can have the generation up to 30% of the CVU. We had an additional margin of BRL23 million. So, this is a new opportunity we have in Pecem.

On to distribution, BRL2 million of losses in Espirito Santo, reaching BRL50 million losses. When compared to the past, we have been improving in that sense. The highlight is the over-contracting controlled investments. In other words, BRL8 million.

On to trading, services, transmission and others, BRL46 million below what we had in the past -- or last year. Very substantial results we had in the same quarter of last year.

On to Slide 7, we have the PMTO. In order to have a consistent PMTO analysis, we have to make some adjustments. We want to provide more transparency to these figures.

The quarter -- or the quarterly analysis is not the best way to see these numbers. We have some occasional improvements, so these comparisons is not the best approach there is. On a quarterly basis, I mean. We have to compare apples to apples, in other words. We have more positive results or expectations toward year's end. It's a 3.3% improvement quarter-on-quarter.

We are keeping on reducing costs below inflation. This is what we have been consistently getting. We have from 0.9% to 1.2% in our PECLD. Tariffs are on the rise. This is something we had in previous quarter.

FINAL

Bloomberg Transcript

FINAL

We have a new registration for the PECLD registered for regular consumption. It's lower for a regular consumption, so this gives us even more transparency. We will have a number right off the bat, but then it will be adjusted. It does not mean we are degrading default rates. We are fighting or trying to reduce losses in a new registration with a more stringent initial projection. This growth is not that substantial.

We have 10% growth in our bases. 12.9%, this can be attributed to the PECLD issue. You can see the same effect in distribution to reduce losses. We believe that the overall gain will be substantial because it makes sense.

On to Slide 8. This is our indebtedness and our leverage rates. This is the adjusted EBITDA and non-recurring transactions. We have 2 times debt or net debt over the EBITDA. It's about 50% of variable rate and 50% of fixed rate. This variable rate can help us capture these lower tariffs.

Let me point out. In Lot 18, we're concluding for long term in the capital markets. This is for the leveraging cycle of that project.

On to Slide 9, a couple of notes on tariffs. In Espirito Santo, as of August 7, it will be ineffective -- or in effect rather for the state of Espirito Santo. Technical losses is 7.06% when we include the tariff revision that we started in 2017. We worked with the Energy Regulatory Agency and we managed to have them accept our requests in that sense. Very similar to the technical losses level that we've seen in the market.

We can have that expected growth. And we were very rigorous in that strategy to implement that CapEx. It's about 0.4%. That's the best rate which will determine the benchmark.

Non-technical losses, it's about 10.8% when compared to 11.45%. In Sao Paulo, we have the public hearing. We will still have some preliminary hearings and we'll have till October. It's about or less than 1% in Sao Paulo.

I'll turn over to Miguel for his final remarks.

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

Thank you, Henrique. Let me give you a few highlights for the expectations for the second half of this year. In terms of distribution, there will be a tariff review in Espirito Santo in August and Sao Paulo in October. And we are convinced we will be rewarded for the efforts we have made to review tariffs and because of the improved efficiency. These are going to be two very important periods in the second half of the year.

We will maintain our focus in controlling losses for the two distributors. The second half of the year will be outstanding for our distribution department.

FINAL

In generation, the outlook is positive too. The highlight would be the reduction of the GSF. We believe that, by year's end, we have -- we will have addressed the issue and will impact the concession extension prospects of our pipelines and, of course, impacting results in the end.

We are committed to capital recycling with more mature assets, as you've seen in our financial reports. Our older plants, these are assets that have been identified that can be sold.

In transmission, the closing of the Lot Q once we start the license and the financing procedures, this will be important too. We will keep on reducing CapEx. 30% of the total CapEx will be performed in the second half.

And finally, we will consider -- just like we did in Lot Q, we'll keep on looking for opportunities in the market if, of course, that opportunity is within our acquisition target. We have a good construction track record in transmission, which is above market average. We're looking for more projects that are at that initial stage. And, of course, we have been very strict in our financial management strategies. And we will keep on working likewise in the secondary market as well.

And finally, financial and corporate management. It's been mentioned already. We are going to complete our financial plans of all transmission lots to maintain costs rising always below inflation. And this is something we have been stressing again and again.

We're going to conclude our digital transformation process, not only for all operations because we are going to optimize the processes in August. Now, we'll have more efficient processes. And, of course, it will optimize our cost structure. Our efficiency will improve too.

Well, this concludes the presentation. I think we can now start the Q&A session. Thank you very much.

## Questions And Answers

### Operator

Speaker O-Operator (Operator Instructions). Maria Carolina Carneiro from Credit Suisse asks the first question.

### Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Thank you. Good morning. I have two questions actually. You've put up a slide talking about the technical notes of tariff review for Sao Paulo. The BR base was very good and you've also included losses as well. ANEEL adjusted other levels. Can you comment on that trajectory? Is this something that you expected? Or will these losses numbers can be further improved following along what happened to EDP Espirito Santo because it improved? Do you expect a similar effect in Sao Paulo?

Bloomberg Transcript

And my second question is about the PECLD provisioning. You said that you want a new -- you want to adopt a new methodology or a new accounting methodology. Let me better understand that situation. This 1.2% of the revenue for Sao Paulo, would that be recurring based on that methodology? Or was it a one-off event? Or should we expect different indicators as of now? Thank you.

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

Thank you, Carol, for your question. I'll turn over the question to the person who is in charge of that tariff review. Let me talk about technical losses first. For EDP Espirito Santo, this is what we do with technical and non-technical losses. For technical losses, it's very complex for us because it simulates the entire network operation. We have a lot of information. A lot of databases that we have to bring in from the grid.

For Espirito Santo, we had some mismatches. And even for consumption data, these inconsistencies had to do with input operations in the software. And we identified that. We told ANEEL about that. I'm not going to give you detail. We changed the network operation because of the construction, and ANEEL understood the differences, and the new technical committee recognized that change. And with the new network and new consumption -- appropriate consumption, losses reached 7.06%. That's what we show on the slide.

In Sao Paulo, this is currently underway. The number that was published by ANEEL is something that indicates the new network setup, all the advisements that were made that reduced technical losses. And this new model is very consistent to reality. There may be some changes, but these are very one-off events, not as relevant as what we had in Espirito Santo.

For non-technical losses, on the other hand, you have the ANEEL model and we revalidate those numbers. And we had access to that final number some two weeks ago. We're still working on the number to identify any inconsistencies. And there won't be major changes to that number. That was expected.

And there was just minor inconsistencies, more for technical. For non-technical losses, they are all aligned with what we had before. All inconsistencies were corrected.

Thank you. Thank you very much

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

Let me talk about PCLD. We have to understand the new rule, 90 days, 180 days. In the new accounting rule that was implemented this year, you have the headquarters taking that data. You can determine what the expected losses will be. I can register that loss on the day it happens because then you'll be able to determine the average for all customers.

We know irregular consumption is more complicated. It's not as consistent an effort as one might expect. This is not a very precise number, therefore. So, these are very

different characteristics in terms of losses. You have great losses, but that's why we have this new system in place to be more transparent.

We have higher losses reported to make sure we are within the limits. So, the initial results will be bigger because we're taking a more conservative approach.

Well, having said that, and your question was about the future expectation, these numbers would be bigger, slightly bigger. And we expect to have better results based on our track record. It's a very complex topic, of course. If you want more detail on how that calculation is made.

**Q - Maria Carolina Carneiro** {BIO 16342681 <GO>}

Oh, no. Thank you. That helps.

**Operator**

Andre Sampaio from Santander asks the next question.

**Q - Andre Sampaio** {BIO 19422379 <GO>}

Good morning. My question is about taxes. PIS and COFINS, you talked about in Q1 about it. And now you have these numbers in your balance sheet for Q2. Can you talk about the fact that there was no impact in the results? Wouldn't you believe to have some reimbursement?

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

This is Henrique Freire. That was neutral, as you said. Andrew Almeida, which is our tax director, I think he can provide you a more detailed answer on that topic because we had a neutral result again.

**A - Andre Luis Nunes de Mello Almeida** {BIO 20620753 <GO>}

Good morning. We had a legal counsel to support our decision. The company was actually representing consumers -- EDP consumers. Every gain that results from PIS/COFINS, benefits have to be transferred over to consumers because we're actually representing them. Very simply speaking, we have an asset to receive from the federal government, from the tax authorities. And we transferred that over to consumers. We depend on ANEEL to determine how it's going to be returned. Is it through the market or is it going to be on a consumer-by-consumer basis? This is something that we have to wait for the regulatory agency. I hope I have answered your question.

**Q - Andre Sampaio** {BIO 19422379 <GO>}

Well, that makes sense. Thank you. Perfect.

**Operator**



(Operator Instructions) Since there are no further questions, Q2 results teleconference comes to an end. Questions submitted through the webcast will be answered by the IR team. Thank you for attending the call, and good afternoon.

FINAL

*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.*

Bloomberg Transcript