

Q3 2017 Earnings Call

Company Participants

- Cristiano Prado Grangeiro, IR Manager
- Marco Antonio Resende Faria, Chief Executive Officer and Business Development Officer
- Marcus Pereira Aucelio, Chief Financial Officer, Director of Investor Relations
- Unidentified Participant
- Unidentified Speaker

Other Participants

- Andre Sampaio, Analyst
- Bruno Pascon, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to the conference call for the Results for the Third Quarter 2017 for Taesa. We would like to inform all participants that the presentation that will be made is available for download on the site www.taesa.com.br/ri and on the MZiQ platform. All participants will be in listen-only mode during the company presentation ensuing this we will go on to the question-and-answer session only for investors and analysts, at which time further instructions will be given. (Operator Instructions)

Before proceeding, we would like to clarify that forward-looking statements made during this conference call referring to the perspective and operating and financial goals for the company are based on beliefs and assumptions of the management and are based on information currently available to the company. These forward-looking statements do not guarantee any performance as they involve risks and uncertainties as they relate to future events and depend on circumstances that may or may not occur. Investors should understand that general economic conditions and other operating factors could affect the future results of the company and lead to results that differ materially from those expressed in the forward-looking statements.

I'd now like to turn the floor over to Mr. Marco Antonio Resende Faria, who will begin the presentation. You may proceed sir.

Marco Antonio Resende Faria {BIO 16679297 <GO>}

FINAL

Good afternoon to all of you and thank you for participating in our conference call to release the results for the third quarter 2017. Before we go on to a more detailed presentation of the results, I would like to refer to some highlights. We have a focus constantly on the efficiency and excellence of our operations, continuously seeking to maintain a sound level of operational performance with the rate of the availability of our lines at a differentiated level. A proof of this is the level of 99.99% of availability rate of our line before the nine months of this year which reflects variation parcel equivalent to that and better results compared to the year before period by period.

Additionally, we continued to present strong operational cash generation, our financial discipline and our efforts towards operational efficiency have given way to high margins which allows us to be in a differentiated position with a relatively low leveraging for this sector, especially during a moment in which the economy of the country is under transition and there is a great deal of political insecurity. It is therefore our understanding that we are at a unique moment to be able to capture opportunities for growth in the short term, and we put our focus on assets that generate value for our business. This is a strategic and core discussion within the company.

We have surveyed several opportunities both in greenfield and in M&A. In greenfield, for example, ANEEL has announced the second auction of this year that will take place on December 15. There would be a 11 lots with a total investment of BRL8.7 billion. We have seen from the interest in lots for the company and our teams are already on the field carrying out special surveys to design our strategy to participate along with the board of management, so that we can present our best rate at the auction in December as we announced previously.

We always do our best to analyze whichever M&A opportunity that comes about and any opportunity that will bring value to Taesa, we will focus fully on these negotiations. As we have already announced, we are mainly waiting to see the process of this investments of Eletrobras and see what happens with the process with the Abengoa assets.

Finally, before I turn the floor over to our Financial Officer and IR Officer, Marcus Aucelio, I would like to remark on the projects that are underway. Presently, we have seven projects in the pre-operational phase, representing a total of BRL4.6 billion in investment and 825 million in RAP. From this amount, five lots were sold in the auctions of April and October 2016, and one lot in the first auction of this year, all of which had and will return above 12% considering the final stage at that time for the auction. We are going to deliver them on time perhaps some earlier on and we are seeking by the efficiency of CapEx and funding, and this is the main focus for the company. This will further leverage the returns on these Projects.

I would once again like to reiterate that the participation and the integration of all of the Taesa teams is what sets us aside and allows us to have success in the construction of these projects. We're doing things differently, we're making things happen. We will deliver all of the projects as planned.

Thank you very much. I would now like to turn the floor over to Marcus Aucelio.

Bloomberg Transcript

Marcus Pereira Aucelio {BIO 19965152 <GO>}

Thank you, Marco. Good afternoon to all of you. I'm going to focus my presentation on slide number three, that refers to the highlights for 2017, the third quarter. We begin with our IFRS results, that happened in first semester of the year. Our result was impacted by macroeconomic indicators. The IPCA and effectively IGP-M, they had an impact on our net revenues for the quarter totaling almost 250 million revenue. This net revenue already present a recovery vis-a-vis the past quarter with an increase of 27%, because the inflation indices have presented a significant improvement in the last month, with a positive impact on the monetary restatement revenue and consequently on the IFRS revenues.

The net financial result also presented an improvement when we compare it with the previous quarter, especially in terms of our cash volume and a drop of the IPCE [ph] and the CDI, which is the index of almost 90% of our debt. With this, the net income for the third quarter reached 9 7.3 million. And I would once again like to reiterate that this is due to the negative monetary restatement over the financial asset.

We can also observe a resumption of our profit vis-a-vis the second quarter of 2017. As this quarter is 35% higher, the company has adopted a procedure to payout its dividends every quarter. This year, we have already paid approximately 423 million, representing a payout of 90%, an amount equivalent to BRL1.23 per unit of Taesa. As we normally do, we are already deliberating this at the Board of Management for the distribution of dividends and interest on shareholders equity referring to third quarter 2017.

We now go on to the regulatory results. With a strong operational cash generation, we ended the third quarter with more than 1 billion in cash, and with this our net debt reached 2.4 billion at the end of this quarter. And the net debt EBITDA ratio dropped to 1.67 times. Our regulatory net revenues amounted to 417 million with a drop of 4.5%. Once again, due to the reduction of the RAP for two concessions in the category TSN and ETEO, that have inferred there 16th year of operation in this new cycle of that extends from 2017 to 2018.

Operational cost and expenses reached 54.5 million, a growth of 32.8%, due to some very -- one-off effects that will be explained by Cristiano further ahead. With this, our consolidated the EBITDA stands at 362.6 million with an EBITDA margin reaching 86.9% . As Cristiano is going to focus on this further ahead, we're going to exclude this one-off effects this quarter. Had did not been for them, the margin would have been 88%, reflecting a decrease vis-a-vis the quarter in 2016, because of the drop of the RAP in those two concessions.

Another highlight that is very important for that company is the issuance of 543 million of debentures, 255 million for infrastructure to fund the Mariana and Miracema projects we obtained excellent funding condition for this first issuance. This is a seven-year debenture closing at IPCA plus 1% per year. And this is one of the best conditions achieved in an infrastructure debenture in this market. With this, we will be able to contribute to the equity of the projects through this funding and our holding at a very low cost, allowing our sectors to be added, especially when compared to the initial period. We further issued 288 million, over 105% of CDI but overall of our debt. And we have a need of 108 million.

Now, with all of these resources, once again, we will not have to research the market tool, our debt in 2018. The results of this operation reinforces the confidence and the credibility that Taesa has with its creditors, besides concerning its very successful background in cash generation and deleveraging.

Finally, I would like to highlight that during the first nine months of the year our rate of availability was up 99.99%. And this shows the incredible operational performance of Taesa and represents one of the main strategic pillars for the company.

I would now like to turn the floor over to Cristiano, who will present in greater detail the results for the third quarter.

Cristiano Prado Grangeiro {BIO 20213891 <GO>}

Thank you, Marcus. Very good afternoon to all of you. We begin on slide number four, where we present the net revenues in IFRS. As Marcus mentioned, they represent 215 million for the quarter with a drop of 41% in the annual comparison. As has already been mentioned, the main impact on net revenues once again is the monetary restatement as we saw in the previous quarter. The impact of monetary restatement on the financial aspects dropped 130 million vis-a-vis third quarter '16. This drop continuous to be expressive, it is the result of the difference of the IGP-M and the IPCA recorded during those two periods. In the third quarter, the IGP-M had a deflation of 1.28% and the IPCA of 0.2%. Last year IGP-M had an inflation of 2.02% and the IPCA of 1.32%. And this difference is what explains the drop of 130 million in the monetary restatement of the financial assets. Another impact on revenues was the drop of 15% in the financial asset remuneration, once again, due to the negative monetary correction registered between the months of May and August that intensified the natural drop of remuneration and the amortization of the financial asset through the RAP.

Before I go on to the next slide, I would like to mention an annual drop in other revenues of over 5 million. The reason for this variation that has had an impact was the tariff review for reinforcement on TSN corresponding to 2014 and that was only applied on -- in the year 2016 to Technical note 196. One of the settlements of that is retroactive was carried out now in the third quarter.

I'm going to spend a few minutes to speak about the macroeconomic impact on our revenues. In the following slide number five, we have prepared two comparative graph for the years 2016 and 2017. Once again, we have the light blue bars, as you can see, that refers to 2016 and the dark blue bar to 2017. The graph shows the evolution of IGP-M, and the one below, the evolution of the IPCA in the last two years. It is worthwhile mentioning that, of the 34 concessions we have at present, seven concessions at our Category III and therefore corrected by the IPCA are still not in operation.

The total financial asset of our operational concession is corrected by the IGP-M in 80% or 85% progressive, reinstated by IPCA, this shows our dependency on our result by IFRS. The interesting thing of this analysis shows that 2017 was in -- a typical year, especially an IGP-M that registered four consecutive month of depletion from April to July. If we

compare 2017 to 2016, we will see that there is a significant decoupling between these periods for both in Brazil, but especially for the IGP-M.

To facilitate your following of our slide, I would like to concentrate the discussion on the higher graph which is the IGP-M to show you our present day dependence over this impact. If we looked at the comparison of the first quarter, the first three bars to the left had undergone the statement by inflation from December to February which is the beginning of the decoupling between 2016 and 2017. The first quarter of '16 had 2.94% of inflation, while the first quarter of '17 had inflation of 1.27%, due to the accelerated reduction of the IGP-M beginning in February of 2017. Therefore the impact on revenues due to the restatement between this quarter was 96.2 million negative which we can see at the bottom of the slide, you can see the impact due to the monetary restatements.

When we go on to the second quarter, we observe a significant increase in those decoupling between the periods. This is because IGP-M recorded two months of deflation 1.1% in April, 0.9% in May. With this there was an accumulated inflation of 2% in the second quarter of '17, and in the second quarter '16, the inflation accumulated to 1.66%. So the greater impact on revenues is due to the monetary restatements and this led to an expected drop in revenues of 172 million as we had informed the last quarter.

When we look at the third quarter, we're still suffering with those months due to the low inflation including June and July of this year. The IGP-M recorded another quarter of accumulated deflation 1.28%, vis-a-vis an accumulated inflation of 2.02 for the third quarter '16. Although we observed this trend for the growth of IGP-M in the last month, the impact from the revenues of the third quarter is still significant of a 130.4 million, lower than what we observed in the last quarter of 172 million.

Now when we look at the data already published for IGP-M and IPCA that impacts our monetary restatement for the fourth quarter, the decoupling between 2016 and 2017 will be reduced substantially. We will have to await for the official data until November, but based on the September and October entities, we can infer that the impact will be lower on the monetary restatement of the financial assets when compared to the last quarter of 2016.

I'm now going to go on with the slide number six, where we speak about costs, expenses, depreciation and amortization in IFRS. In this quarter of 2017, cost totaled BRL81.2 million, with a growth of 20.5% in the year-on-year comparison. This increase is due to one-time events that I'll highlight: the cost of personnel increased 22% year-on-year due to the capitalization of personnel costs during the third semester of 2016 in the projects, due to the salary readjustment based on the collective bargaining and the recession of three executive that are now hired on a pure statutory regime, the latter one due to the deliberation of the management board will bring [ph] back some benefits, for example, future savings in the payment of INSF [ph]. This recession that took place was at the end of the turnover (inaudible) and therefore the company simply anticipated the severance costs.

FINAL

The increase of almost 9% in the cost of third-party simply explained by the cost of the 4th issuance of debentures that was concluded in October. The cost of issuance was reclassified as a financial expense, and therefore, temporarily we will have an impact on EBITDA. In other expenses, the increased of 6.6 million in the comparison during the quarter is due to the allocation of the cost of indemnification to the cost of construction that occurred in the third quarter of '16 and to the growth of cost relating to the law on fiscal incentive, the Rouanet Law and the law for the incentive of sports, for example.

If we normalize that cost of the period compared 2016 and 2017, if we exclude those one-off events, the variation would be 11.2% as you can see on the graph at the right of the slide, mainly due to the O&M cost that increased and the cost relating to the fiscal incentive laws. In the later one, we have a counterpart through the reduction of taxes which generated no impact for effect in net revenues.

We now go on to slide number seven to speak about the financial results. The revenues were 47.4 million for this quarter with a drop of 49%, vis-a-vis the same period in 2016, aligned with what we have announced last semester. The financial revenues have been growing, thanks to accumulation of cash during 2017 with an impact of 4.4 million and there was a drop in interest 24.4% because of the IPCA and because of the lower balance of the debt. And the exchange rate have a drop as well because of the reduction of IPCA and CDI during the period.

We're now going to go on to slide number eight. The equity shareholder results also had a drop, once again, because of the macroeconomic indices that we found in Taesa, especially for the concessions of TBE given the relevances as per the growth. Now if we observe the lower graph of the slide that refers to the net revenues of the third quarter that stood at BRL97.3 million with a reduction of 55.3% year-on-year, once again primarily affected by the macroeconomic indices and the monetary restatements with an impact on the revenue and the shareholders' equity. Despite this drop that we have year-on-year, it was (inaudible) to observe a sequential enhancement in -- on revenues of more than 35% because of the resumption at IGP-M as we mentioned previously.

On slide number nine, we're going to present to you the regulatory results. Net operational revenue, the consolidated one ended the quarter with 417 million. And as Marcus mentioned at the beginning, a reduction of 4.5% vis-a-vis the third quarter 2016. If we consider the state and the companies that we're investing jointly or in affiliate, the total revenues was 522 million for the quarter. This negative variation of 4% is due to the drop in the RAP in the concession on TSN and ETEO that have entered the 16th year of operation in the 2017-2018 cycle.

As I mentioned in the IFRS revenue, the line item are the revenues for regulatory (inaudible) have been affected by the reinforcement of tariffs review for TSN due to the Technical Note of ANEEL, once again, the negative effect is 5 million on revenue for this quarter.

We go on to the slide number 10 where we show you the regulatory EBITDA. As we always mention, this is the best indicator to show you our ability to generate operational

cash for the company. In this quarter, consolidated EBITDA was BRL362.6 million with an annual drop of 8.4%. The EBITDA margin therefore was at 86.9%. From the viewpoint of revenue, this drop was caused because of the reduction of RAP, TSN, ETEO, and from the cost viewpoint, as we will mention in slide number 10 due to one of events that had an impact as we mentioned previously on each of the concession.

So these are non-recurring events and results, it is our understanding that it is prudent to present a normalized EBITDA excluding this one-off event. The normalized EBITDA, the drop would be 4.9% year-on-year as you see in the graph to the right, and the EBITDA margin would stand at 88%, giving us a drop of 1.4 percentage points vis-a-vis the (Technical Difficulty) drop once again refers to the reduction of 50% of wrapping the concessions, TSN and ETEO. I think it is important to record here that we continue to be very determined and stringent in our cost control. This is the pillar in the company and have set us aside in the transmission sector and will tariff [ph] be a benchmark in terms of operational efficiency in the sector. Our revenue that we adjusted annually by the IPCA and IGP-M depending on the concession and we have been successful in (inaudible) mix in the collective bargaining agreement of our employees. In terms of the third parties, in the readjustment of contract, we used the same readjustment used for the RAP. Thus we were able to reduce the impact on inflation in our operating margins.

We now go on slide number 11, where we show you the Taesa indebtedness. The net debt of the company reached 3.5 billion at the end of the third quarter with the amortization profile presented in the higher part of the slide. 70% of the debt is long-term in terms of maturity. Our cash position reached more than BRL1 billion at the end of September, 36.2% greater than what was recorded the last quarter. As a consequence, Taesa's net debt reached 2.4 billion this quarter with a reduction of 21% in the annual comparison on 10.4% in the sequential comparison. The net debt to EBITDA ratio stands at 1.57 times compared to 2.0 recorded in the same period last year. This reduction shows the speed with which the company is able to deleverage, an important differential that we assess constantly in terms of growth opportunities.

If we consider our present day cash volume, our need to (inaudible) short-term debt is very low. As we already mentioned, we recently concluded our debenture issue amounting to 543 million, part of our overall debt and parts for the Mariana and Miracema projects. Once again, this shows the confidence of our creditors and puts us in a state of a position to have greater issuances in the future, whenever necessary if it's for projects or for our debt.

With this, we would like to conclude the presentation and we will now open the floor for questions-and-answers.

Questions And Answers

Operator

Thank you very much. We will now go on to the question-and-answer session only for investors and analysts. (Operator Instructions) Our first question is from Mr. Victor

(inaudible) you may proceed sir.

A - Unidentified Participant

Your leveraging -- presently the company is working with deleveraged capital. Nevertheless in 2018, there will be a further drop in RAP. What are you expecting because of this, once again was disseminated in media. Is that Taesa would be interested in (inaudible) lots will be auctioned at the end of this year. These are large lots with a CapEx of at least 3 million. I would like to understand therefore what would be your net EBITDA structure and capital that you would feel comfortable with, keeping in mind the increase of this indicative for the coming year and the drop in the RAP, the permitted annual income?

A - Unidentified Speaker

Good afternoon, Victor. Initially we are interested in the auction. We would be extremely pleased if we could be granted all of the lot, but given the competition and considering what has happened in the past, our expectation is to participate of course and always have a financial growth to add value to the company and to add value for our shareholders. Once again, this is a great priority that we focus on for the auction of November what we have been surveying the lots. Our engineering team are on the field, in the areas carrying out analysis, an engineering analysis, as well as environmental and other types of analysis, and all of this will enable us to make a decision in-house to see which are the main lots that we're going to bid for and the lots that perhaps we can try to bid for alone or those lots that we could bid for in partnership. This is the policy that we have adopted since April of 2016, since the first lot that we were granted in the auction. And in terms of leverage, we are at 157 [ph] ratio. And in December, we have our covenants, we have 3.53 [ph] net debt/EBITDA ratio. And when we speak to analyst, they say if Taesa gets to 4, we will have that AAA, therefore we have a very high speed of leveraging. And that means that we will wait and see which are the best lot and the amount that we can make in our future business. And this will enable us to carry out acquisitions and also take part in the auctions, because the disbursements of investment usually take place in the third -- fourth year the construction of these assets.

A - Unidentified Participant

Thank you very much for your explanation.

Operator

Our next question is Mr. Sampaio [ph] from Santander. You may proceed, Mr. Sampaio.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good afternoon. And I would like to ask a question on the tariff revision of your concession? We have observed in your calculation and once again I would like to hear your opinion on this and would have a somewhat more color from the technical team, if possible?

FINAL

A - Unidentified Speaker

I would like to clarify the -- following the tariff review refers to some of our assets. What I would like to know is what you thought about the WACC [ph] process of calculation, because we believe that the impact would be only for specific concession. And in the statement of our results that we are presenting now, you can see the concessions throughout the year, where we have maintained our operational efficiency. All of this continues to be under analysis by ANEEL according to the hearing that was recently (Technical Difficulty). There were meeting of ANEEL with an association where several of the Chairman and officers that's the company in the attempt to show to ANEEL that the policy that have to be revisited, the ranking that has been presented once again is not in accordance with our reality. And we certainly hope that the electricity agency will revisit this and make some necessary changes.

Q - Andre Sampaio {BIO 19422379 <GO>}

Thank you very much.

Operator

(Operator Instructions). Our next question is from Mr. Victor Menezes from Goldman Sachs. You may proceed sir.

Q - Bruno Pascon {BIO 16451201 <GO>}

Hi good afternoon, this is the Bruno who is speaking. My question refers to your capital infrastructure. The cash generation at present has been quite sound. You have generated 319 million per quarter, and I would like to know if the company is going to pay out lower dividends, let's say pay lower dividend that can have a more accelerated leveraging and then they will be able to leverage all of the CapEx revenue projects. So help me to understand this, if there is a cut-off 50% in the RAP, and 59% in IPCA. The accounting results will be greater than the cash generation, and I would like to understand that the company will continue to pay dividend based on their profit from IGP-M or if they could lower the dividend once again to continue to seek out acquisitions, as long as all of the bring a greater returns? I wanted to gain a better understanding at your cash generation at a point in time and there has been a reduction in RAP and because of the IRFGS [ph].

A - Unidentified Speaker

Good afternoon, Bruno. When we include this in our model, the accounting result, the IFRS, we also have to think about the regulatory result. Even with the reduction of the RAP and with the new projects, where we are going to increase our indebtedness, it comes very close, but it never overcomes the results. What we have discussed with our controller assures that that would make sense to maintain the present day level of dividend that the company has been paying now.

This is an ongoing discussion that we hold within that company. At every meeting, we think about our future capital need and where we are going in terms of leveraging and the payments of dividends. For the time being, we don't think that there will be any impact or effects that will lead the company to reduce the payout that we have adopted in the past.

Q - Bruno Pascon {BIO 16451201 <GO>}

That's very clear . Thank you very much.

Operator

(Operator Instructions) As there are no more question, I will now turn the floor over to Mr. Marco Antonio for his closing remarks. You may proceed sir with your closing remarks.

A - Marco Antonio Resende Faria {BIO 16679297 <GO>}

I simply would like to thank all of you for your participation and say that our IR team is at your entire disposal for any doubts or clarifications that you may need. Thank you very much.

Operator

Thank you. The conference call for the results of the third quarter 2017 for Taesa ends here. You can now disconnect your lines.

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.

FINAL

Bloomberg Transcript