

Q1 2015 Earnings Call

Company Participants

- Henrique Freire, CFO
- Miguel Setas, CEO, IRO

Other Participants

- Bruno Pascual, Analyst
- Dionicio Subani, Analyst

Presentation

Operator

Welcome to EDP Energias Do Brasil conference call to discuss the earnings of the First Quarter 2015. All participants are connected in listen-only mode. Later on, we are going to start the Q&A session when certain instructions will be provided. (Operator Instructions)

This presentation together with its slides will be simultaneously webcast on the Company's website www.EDPbr.com.br/ri. In there you will also be able to get hold of the Company's earnings release.

Before going on, EDP Energias do Brasil would like to let you know that any statements made during this conference call relative to the Company's business outlook as well as projections, operating and financial goals relative to its potential growth are just assumptions based on the Company's expectations with regard to the future of EDP Energias do Brasil.

Forward-looking statements depend on the country's economic scenario, the performance and regulation of the electric industry in addition to other variables and therefore are subject to changes.

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

Miguel Setas

Good afternoon, everyone. I'd like to start by welcoming you to the earnings call for EDP Energias do Brasil regarding the First Quarter of 2015. Also, I'd like to tell you that today with me are our VP of Finance, Henrique Freire, Distribution, Michel Itkes. And our CFO, Miguel Abitakes [ph].

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In this quarter, I'd like to start by commenting on changes that took place on the governance structure of our company. So I would like you to page three of our presentation and tell us that for us, this is a key point of the Company's strategy.

This slide, I'd like to call your attention to three points that are very important in our opinion. First is that our board of directors today have a comparative [ph] relationship between members that are appointed by EDP's shareholders or members and also for independent members.

Also, as of this moment, Antonio Mexia, the President of EDP Group is also the Chairman of our Board of Directors of EDP Energias do Brasil. Associated to that, the four members that are appointed by EDP are today part of EDP's top management board. So the shareholders are at high level represented by the board of directors of EDP Energias do Brasil.

Another point that I would like to highlight is the profile of our independent members. So Jose Luiz Alqueres, the newest member, he is very well-known in the industry, former president of Eletrobras Light. So a man with a large experience in the electric industry and that's joined out board now.

I'd like to draw your attention to the fact that all the committees that provide advice to the board are that governance and sustainability will be shared by independent members of the board of directors with one exception based on the bylaws which is the Compensation Committee which is going to be headed by the Chairman of the Board, Mr. Antonio Mexia.

And also, the CEO to call her [ph] directly Investor Relations and our former CFO, Miguel Amaro went to bear and now he is going to be replacing him and Michel, as well, that is here, present, they are both here present in this conference call.

The other areas remained -- generation and distribution remained with the members of the board that were heading the areas of vote for [ph].

On page 4, I would like just to say a bit about the context of the First Quarter of 2015. And basically, this contextualization has the objective of highlighting in reassuring that we still are going through very challenging times in terms of generation, water supply, which puts pressure on generating units and therefore, we have a reduction of our initial expectations in terms of businesses for the year.

This impact on electric power generators that you will see further, one was partially offset by the new tariff in the distribution segment that enabled us for the First Quarter of 2015 to have resilient results in line and in continuity with what was seen in the year of 2014. We are going to see that in details in the presentation that we are going to have with Henrique Freire.

Then on the next slide, we have five highlights of our performance. The first is something that we have been talking about in our recent meetings which is a clear strategy of the Company as a hydrothermal operator integrated to businesses of generation and distribution and with the hydro and thermal energy.

And here, we had an evolution of two negotiations that compete -- that contributed to this strategy. First, the recent completion already in the first -- past -- the first call before this call of the negotiation of EDP Renovaveis Brasil for sale of 45% of our share which will translate into additional cash of the Company of BRL176 million in the year [ph] in the total amount of the transaction of BRL190 million. So BRL176 million will be incorporated to the Company in 2015. So this is the first note in terms of our hydrothermal positioning.

The second is the evolution of the transaction was delivered [ph] for the acquisition of 50% of Pecem I HPP. And as you know, in our general meeting of creditors, we had another landmark for this negotiation to be completed.

With now, we have the recovery plan for another which was one of the mandatory things for -- to happen for the Chuga 1 [ph]. So this is still in progress but we took a further step towards that.

I'm going to go on with these points on page 4, on the next slide. So I'm not going to say so much on this page 4. So we go to page five where we show an overview of what's going on in Cachoeira Caldeirao HPP which is one of the three plants that we have under construction. This idea is already in operation. Cachoeira Caldeirao today has a level of completion of 80%.

And in the presentation, basically, you have an aerial view of the plant. And as you can see, the degree of the development of the work is quite significant.

And in here on the slide, you have details about the activities that are being developed right now. This is obviously something that is crucial in our strategy. I always like to talk about that, the capacity of delivery, the investments that we took over.

We had it already [ph] and we are bringing the same experience, the same management to our ongoing construction works with Sao Manoel and Cachoeira Caldeirao. So the 80% of completion already enables us to expect some kind of advance in the startup of this plant.

I'd like you to go to page six now just to give again an overview about our project in Sao Manoel. This picture is again on an aerial view of the construction site. And here, I'd like to draw your attention to the fact that, well, obviously, we are in the very beginning of the construction work. We have 8.5% of completion so far.

But it's important to tell you that it is absolutely within its limits of time and budget. The contractor is already -- have already acquired all the equipments necessary for the implementation of this construction site.

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We have 2,000 employees over there with an ascending curve of a location of resources and we expect the peak -- at the peak of work to have 4,300 people. So out of the 4,300 people, we have 2,000 already working onsite.

We have already completed the deviation of the river in this first phase and now, basically, we are doing the excavations of the powerhouse, the spillway, the concrete structure of the water withdrawal and intake and also completion of the work on the construction site itself.

And also to be added that the purchase of equipment is within plan and all environmental licenses are going on as planned. So we are very much aware of the fact that this project is a lot more challenging than the two previous ones. But we are giving time to this company to really make sure that implementation is going to be as smooth as possible.

I'm going to ask you to go to page seven now to talk about the third message that I would like to highlight in my presentation which is the Pecem turnaround, operational turnaround, economic turnaround.

And here, I'd like to draw your attention to the fact -- to the evolution of our EBITDA. We have a positive EBITDA in the First Quarter of '15 of BRL46 million relative to 50% of EDP's share. And added to that, we also have a significant improvement [ph] in the availability of the plant. So in the First Quarter of 2015, the plant has a level of availability of 96%.

If we take a look at the accrued numbers year-to-date, we are talking about 92%. So in the First Quarter, 96% of availability.

On the right portion of the slide, you are going to see that we have the results of the two regulatory pleas that translated into an addition of BRL35.5 million for the cash flow of this project.

And also in the very bottom part of the slide, we have the authorization from ANEEL, the recognition from ANEEL of having an increase of physical guarantee that's translated in plus 14.3 average megawatts which improves the economic profile of this project. So very consistent news in our position, improved our expectations about Pecem.

And finally and before turning the call over to Henrique Freire, our CFO, I'd like you to turn to page eight where you have the fourth message that we would like to share with you which is basically the overall improvement that we had in our operational indicators in our both distributors, Bandeirante and Escelsa.

And I would like to talk about quality of service. If you see the sites [ph], sites [ph] of the two companies are quite stable in an ascending curve. And the situation in terms of regulatory issues means that we are fully meeting the regulatory objectives that the companies had.

But perhaps, the most important message is on the right part of the charts that showed the evolution of non-technical losses, that is commercial losses. And the highlight is the reduction of 0.35percentage points in EDP Bandeirante.

So we decreased the losses in a low voltage [ph] to 11.8%. You had the history from about 20% in 2009. And today, we are very close to the regulatory levels. This evolution was remarkable.

And in Escelsa, we know that this is a company that still has more resilience in terms of losses but we have a reduction of 1.13percentage points going to losses to close to 16.5%.

We are so far from the regulatory limit but this distance, as you know, will be shortened as of the next tariff cycle of 2016 when the curve and the trajectory of losses is going to reviewed at. So our loss program is being identified. The highlight in the First Quarter was telemetering and our project to decrease losses, we have been talking to the market about that, explaining what's going on.

So this results -- this project yields excellent results. And in addition to that, we have to understand that the repositioning of our losses is going to really shorten the difference between the real amounts and the regulatory amount. So this was the fourth message.

And the fifth message. And with that, I turn the call over to Henrique who was to talk about risks. And here, I'd like to tell you that our indebtedness level and risk levels are very much aligned in the First Quarter that was a very small [ph] BRL920 million that will help us to cope with our investments. And in the end of this quarter, our indebtedness was 1.2 times of that EBITDA ratio.

So we are keeping a controlled risk profile particularly in the challenging time of the industry, we have a cash generation that we believe is quite cautious.

With that, I close my part and basically these were the six points of governance being the six points to re-enforce governance strategy clarity, commitment of the investments, turnaround in critical assets like Pecem, improvements of operational efficiency in our distribution companies and mitigation of our risk factors.

With that, I turn the call over to our CFO, Henrique.

Henrique Freire {BIO 19117781 <GO>}

Well. Good afternoon, everyone. We are going to slide number 9 where -- which show the financing that we had for the First Quarter. As I told you, we have the disbursement of BRL920, a 150 million -- BRL750 for the promissory note in the contract of March '15. And then the credit lines from the BNDES of the first disbursement of BRL170 million and BRL90 million both Bandeirante and the rest in Escelsa. So altogether, we have a cost of finance of CDI plus 1.9%.

We have also the second disbursement in April of BRL221 million and the maturity is 2022, 2024. And this elongates the profile of our debt which is part of our risk strategy and our financing.

In terms of construction projects, I'd like to talk about the debentures of infrastructure of 156 million in the Cachoeira Caldeirao power plant and a maturity for 15 years.

Talking in terms of continuity of our debt in our full consolidation except for Sao Manoel (inaudible), we had the debt (inaudible) of BRL4.109 million. But in terms of net debt because there was a maintenance of EBITDA as you can see, there was a decrease of the debt to 2.3 million and net debt was -- I'm sorry, the net debt to EBITDA ratio was 1.2 times.

On slide 10, we showed the evolution of our gross margin in the three businesses, of generation, distribution and commercialization. In the first part of the chart, we have a positive evolution of our gross margin that went to 306 million to 426, a very important growth.

And there are two things that contribute to this increase, first, the parcel B of BRL42 million. We also have a market negative number of 22 but we have an increase of non-invoice of BRL84 million. That is energy that was delivered to the clients but not invoiced yet. But it is already updated to the new tariff that we had in the country.

And in terms of generation, generation was quite affected by Brazil water conditions. We see that GSF accounts for a reduction of 124 and we went from 274 to 204. And basically 124 is GSF. Remember that the last year, we had a GSF of 93 and this is a lot higher.

And we continue with our strategy of mitigating these effects with hedge and seasonalization of BRL70 million. And we have an option of a seasonalization to use our energy better in this quarter. And with that, we mitigate to GSF.

As for commercialization, this quarter is a quarter of a low volatility in the commercialization units differently from last year, that was a quarter of opportunity. And with that, we decreased our gross margin going from 56 to 33.

Going to slide number 11, we have an analysis of our PMTO. And looking at the Fourth Quarter of 2014, the First Quarter of 2014 and the First Quarter of 2015. And if you compare to the First Quarter of 2014, we have an evolution in line with the inflation accumulated in the period with growth of 8.7%.

If we compare to the costs that we had in the last quarter of 2014, we did have a reduction of cost. Those costs in 2014 had some costs that were non-recurrent. Even if we mitigate those costs, we exclude these costs, we would have a comparable base saying that the First Quarter of 2015 is in line with the last quarter of the year. So we are maintaining our costs.

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Taking a look at the different lines, we had an increase of personnel of 7%, third parties' production -- I'm sorry, a material reduction of 11%. And what really contributed to this increase was provision, we had an increase of BRL10 million. And what explains this was the increase of the bad credits of EDP Escelsa and also a change in the criteria of how we book this amount. And also some clients that led us to increase this provision.

So going to the last slide, slide number 12, we have our conclusion as has been said in terms of EBITDA and considering all the factors we've talked about, we went from 406 to 409. So again, very much in line compared to last year.

And net income and this EBITDA already has the effect that's in distribution, we had a relative growth of 62%. And in generation, we have the drop of 26 and commercialization 43. So the combined effect led us to stabilization of our results.

And in terms of net income in the last -- in the First Quarter of 2014 was BRL100 million. And in this period, there was a reduction of 16 million. You can see if you want to know the main factors that led to the final results, we have the equity equivalent that is -- companies that are not controlled by EDP, contributed with minus 24 million.

We have Pecem that had a positive performance in terms of EBITDA. But in terms of financial results, we were penalized and this contributes to our final numbers. So this is one of the main items responsible for the reduction.

Well I think that this is it and we are going to open for your questions. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now start with the Q&A session. (Operator Instructions) We'd like to draw your attention to the fact that any questions in English are going to be answered in Portuguese and translated simultaneously into English.

Or first question is from Dionicio Subani [ph] from UBS.

Q - Dionicio Subani

Hello. Good afternoon. Thanks for the call. I'd like to understand clearer the next step for the completion of the purchase of PC1 [ph]?

A - Miguel Setas

This is Miguel Setas speaking. Well those purchases as I mentioned has the first condition. The approval of any recovery plan that took place in the general meeting of the last 30th and then it has to be approved by the legal recovery judge.

Upon approval, we would be ready to complete the purchase. We have to take into consideration that the creditors of the project, IDB and BNDES, already approved the process. So we are just waiting for the final decision of the judge that is judging the case.

Q - Dionicio Subani

Okay, I understand. If you will allow me, I'm going to ask you another question about the sale of Eletrobras distributors. Is EDP Energias do Brasil interested in any of them or is it outside their scope?

A - Miguel Setas

Well I have been -- always been very clear about this topic. We are now in the phase of implementation of three hydropower plants. We have the acquisition of Pecem [ph] as you mentioned and so we believe that these are our focus of the investments now in addition to the organic evolution of our businesses and distribution. So I would say that our focus in terms of investments will remain on the three projects that are ongoing as I have been saying and the acquisition of Pecem [ph].

Q - Dionicio Subani

Okay. Thank you very much.

Operator

(Operator Instructions) Our next question comes from Bruno Pascual [ph] from Goldman Sachs.

Q - Bruno Pascual

Well. Good afternoon, everyone. Thanks for your call. I have two questions. The first, the quick question, I just would like to understand what made the change in the non-invoice calculation criteria. It's different now than it was in the previous message. I'd like to understand why -- you know, how this will behave in the following quarters.

The second question is about the effects of the special tariff review that was just invoiced in April but this will have an impact on the Second Quarter of the Company. So I would like to know your evolution of the bad credit accounts if you have an increase in this line because of this tariff increase as of April. So I would like you to comment on the behavior until now, May.

A - Miguel Setas

Well as for your question about the non-invoiced, in the past, we use the average tariff and the tariff readjustments of the 23rd. So the impact was very little, just a few days.

And we had the smaller readjustments and now, we had the special revision that was considerable as of the day one of the month. So it's not invoiced but it will be fully invoiced in our accounts. So because it was as of the 1st of the month, we decided to consider that. In the past, it was just as of the 23rd of the month.

Q - Bruno Pascual

Okay, I got it, thank you.

A - Miguel Setas

As for bad credits, we had an increase with Escelsa but it was a non-recurrent event of 3 million due because of a migration of the system which is something of the past, there were -- there was a fine, an interest. And it was this correction. But this is non-recurrent.

And we have been (inaudible) of a hospital that is in a legal recovery process and we are contacting the representatives. But we do see there is an increase of default levels but we're still -- it's very recent. It's only five days so we cannot say.

Generally, default levels are high but remember that because we consider default rates just as of the 45 days, we will still need to wait a bit to know if the default levels are going really to go up and what the day will be.

But we know that the tariffs are higher and the absolute number of default levels will also go up but we don't know exactly how much it will be yet.

Q - Bruno Pascual

Okay, Miguel, thank you very much.

A - Miguel Setas

You're welcome.

Operator

(Operator Instructions)

A - Miguel Setas

if there are no further questions, EDP Energias do Brasil's conference call to discuss the earnings of the First Quarter 2015 is now close. Questions taken on the webcast will be later answered by the IR team.

We would like to thank you very much for joining us. Have a good afternoon and thanks for using Firstcall [ph].

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