

Q2 2019 Earnings Call

Company Participants

- Eduardo Antonio Gori Sattamini, Chief Executive Officer And Chief Financial And Investor Relations Officer

Other Participants

- Maria Carolina Carneiro, Analyst
- Thiago Silva, Analysts

Presentation

Operator

Good morning. And this is ENGIE Brasil Energia's conference call where we will discuss the results for the second quarter 2019. All participants are connected as listeners only and ensuing this, we will open the question-and-answer session, when further instructions will be given to participate. (Operator Instructions) We remind you that this conference call is being recorded.

This presentation, followed by slides, will be simultaneously transmitted through the Internet through www.engie.com.br/investors. The slide presentation and the Company's earnings release are also available on the website.

Before proceeding, I would like to clarify that forward-looking statements made during this conference call regarding the Company's business outlook should be treated as forecast that depend on the country's macroeconomic conditions and the performance and regulation of the electrical sector besides other variables. Therefore, they are due to changes.

With us today, we have Mr. Eduardo Sattamini, CEO, Chief Financial and Investor Relations Officer of ENGIE Brasil and Mr. Rafael Bosio, Investor Relations Manager, who will talk about the Company's performance in the second quarter 2019. Immediately thereafter, they will respond to the questions. We would like to remind journalists that should they wish to ask questions, they can send them to the C

Company's press office.

I would now like to give the floor to Mr. Sattamini. You may proceed, sir.

Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

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A good day to all of you once again. It is a pleasure to be able to speak about the second quarter of 2019.

And the first piece of information is that, as of the 15th of August at the meeting that we will hold, we have named Marcelo Malta, a professional that has been with us for several years, and who was the Director of some of our areas, and we have worked in partnership. He was a member of the Board of our Foundation (inaudible) and he will be helping me to relieve the load on me and will therefore give me the opportunity to focus on the main business of the Company. And once again, this is a group strategy of maintaining the information within the Company as much as possible.

Very well, let us speak about our results. The results of this quarter, once again, reinforce what we have been saying for many years that quarter-on-quarter, year-after-year, perhaps this is not the best way of conveying information. This is what the market demands. And in the second quarter of 2019 vis-a-vis the first quarter of 2018 we did have a drop in EBITDA during the period. Once again, because of the difference in the two years, because of the level of difference in the profit and loss.

And additionally, we did have a non-recurrent claim that we won in 2018 that did not happen again. And we had 18 days of the property of an asset, which did give us a certain revenue, but all of the expenses that also refer to this transaction. All of these factors, once again have contributed to having a drop, but when we look at the quarter as a whole and the semester, we see that this is not a very accentuated drop, especially in non-recurring effects.

So let us begin speaking about our net income. Our net income was somewhat higher, mainly due to the trading assets. We had several million in net income, these are the net income. In the same quarter in 2018, we also had a drop in revenues due to the settlement of the short-term market. So once again in the second quarter, this year vis-a-vis the second quarter of 2018, an increase in the average price of 3.8% and a consolidation of a company, once again, contributing with BRL23 million for the revenues of this quarter. Simply to give you an idea, in the second quarter of 2018, we had BRL302 million, compared to BRL187 million for the second quarter of 2019. On the average, the P&L can be justified therefore. In the middle of May and April, we did have this impact.

When we look at the EBITDA, we had a drop of 3.7%. If we look at the semester, there is a very minor change, and this is a non-recurring change and it would be 4% or 5% if we were to take away that non-recurring claim that we had in the second quarter of 2018. And in the second quarter of 2018, we would have to take away 300. Once again, because of these non-recurring things, we would have 4%, 4.5% growth of our EBITDA. The net income was good, but not sufficient to reverse this drop. We also had a significant increase in our net debt. If you look at the second quarter '18, it was BRL6 million to BRL11 million, despite having a lower inflation rate, and we had financial expenses that were much greater.

And these financial expenses, once again, results from investments that so far have not been able to make significant contribution. We will see this in greater detail and this has

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contributed with 18 days of drop, small drop. And the other factor is Umburanas where we concluded deconstruction at the end of the month of April, and we still have the possibility of enjoying the full contribution of this part. And Trairi still does not reflect in the results of the company. This is natural, it is a company where we are still investing. It is a very good opportunity. And of course, if we have the opportunity to leverage it more, we have very low indebtedness, we have good capital and once again, we consider our indebtedness as being very good. And the figures that we have at present are ideal to be able to maintain our indebtedness, but of course we can become more efficient. And this does not mean that we're not going to continue growing. We are going to find ways to continue growing and there are opportunities in the market that can be captured. And if we see new enterprises until the end of the year we of course, will take these opportunities, as well as any other eventual opportunities in M&A.

We go on to Slide Number 6, where we speak about our highlights. We had the acquisition of TAG was done on June 13. We have a stake of 90% and we do have an indirect stake of 25%, where we have partnership with CDPQ. Something else had happened in the second quarter of 2019, on June 28, we had a commercial contract with the capacity. And once again, the contracts that ended on June 1, we would like to remind you that we have renegotiated the sale with the regulated market. Most of our contracts have been restated. We were guaranteeing that most of the contracts in the first semester would be renegotiated and canceled. And as of this date, we now have new contracts with variable revenues when it comes to generation.

On July 15 of this quarter, we carried out the ninth issue of simple infrastructure debentures in four series. Once again, this is the first of its kind in the country, totaling BRL1.6 billion, and we had BRL15 billion or BRL20 billion [ph] of efficiency in the placement because an issue of this size, we deemed this to be a victory. We have never obtained such low-cost resources as these. And as part of our business plan, this fundraising did make full spend.

Additionally, on Slide Number 7, another highlight, a new partnership with L'Oreal that as of this moment onwards, they will begin using clean energy from our Trairi Wind Complex. Now this is the path that we have found and that have decided to tread in the sense that we will be able to decarbonize our clients. And we're going to, of course, go towards a lower carbon economy and offer certificates for clean development. And we're now working towards further decarbonization of our customers.

In Slide Number 9, in terms of our shareholding structure and business segments, the only change would be that of TAG, 25% stake for the CDPQ and we have 90% stake. And we have already seen interest in selling the stake and we will see if the opportunity comes up in the following months.

In Slide Number 10, a slight change in our presentation. We now have several business lines in terms of generation, which is still our main business. Presently, we have 60 power plants that are under operation, with 8.7 gigawatts. This is our position at present, and this at Pampa Sul and others that came into operation during the quarter. We have five more substations, transmission, distributes the solar generation, a total of 2,000 installed systems with 28.27 kilowatts peak of capacity. This is an activity that has grown significantly

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because we're concentrating on the B2B market, less on the residential market. And once again, our focus at present is the B2B market through long-term contracts.

And we would like to speak about our matrix and our participation in thermal energy because of Pampa. Now, we have already expressed interest in selling some of these assets. We want to move away from the coal field assets. We're undertaking negotiations, we're at advanced stages, we do have potential buyers. We're simply discussing the risk, and we hope that these operations will still take place in 2019. Now when it comes to Pampa, with the entry into commercial operations, we should go back to this process. Of course, this process will take time. We have to convene all of the interested parties, we signed confidentiality contracts, we will receive different binding price offers. And what we are imagining is that this process will be underway during the second semester of this year with the potential closing of this operation in the future, next year.

We go to Slide Number 11, where you see a bit of our history in terms of energy generation. Our installed capacity, as you can see, many of these companies have been growing, especially in the last three years, taking advantage of the opportunities in the market, with a significant return as well. When we look at the very low interest rates, we see that the long term return or at least what we had in the past, has improved. In the bottom part, we show you that we are leaders in the market in the private sector. This is our own installed capacity. We had a growth of 1.9%. And in general, we have 10.6% and some of this coming from Jirau. We have come to a standstill in that process. And once again, we're once again reviewing the structural issues of the project and the levels of operation. Once again, these issues that we're working on this project and we hope to be able to resolve all of these problems.

We announced the exit of Edson da Silva as of October 1. He's going to be working for Energia Sustentavel do Brasil that operates Jirau, and he will be replaced as of the 1st of October by Marco, who is also a career professional and has been in the company. Once again, this will be announced. This is something that will only be happening as of October 1, but it is important for us to have a person with many years of market experience, that is very competent when it comes to regulatory issues and a very good negotiator to improve this project, and this will enable us to work more smoothly with our portfolio. We did have an increase in our market share of 3.6% in the second -- in the first semester because of the added capacity.

In the next slide, we speak a bit about TAG the natural gas. We have already referred to the technical characteristics of the company. We're working in partnership with ENGIE S.A. and CDPQ. We do have a group working at present with several professionals that also come from ENGIE Brasil in the management of TAG. And our Director has now become the CEO of the company. This is the third change that we have in our Board. Mr. Pehari who was our business manager, will now become the manager for development and will be responsible not only for the development part, but also for innovation and strategy. These are new areas so that innovation will be at the service of new business. We deem innovation as being something that can thrust our business development, give thrust to our business development.

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In Slide Number 13, we once again refer to natural gas and it is important to mention the average maturity of TAG. And during these two years, we will have periods where the regulated price will be in effect. And at the appropriate moment, we will announce a new tariff, and this tariff will be based on the optimization of the gas lines. And based on the return required on assets, of course, that will be better managed. And we're doing this with a great deal of serenity so that we can have a better forecast of our dividends.

On Slide Number 14, in transmission, there are no great novelties. The only novelties perhaps refers to Gralha Azul. We are working on this process as normal. And once again a change in our market share. We're obtaining more comfort once again and once again, increasing our market share. We're developing the business. We're looking for the best model for this and we are attempting to work in the B2B market, once again with the view to having a BOT or BLO model and this is our strategy when it comes to distributed solar generation.

Let us go on to Slide Number 17, where we speak about the energy market. As always we underscore the issue of an oversupply that we have considered because of the hydrology, but this oversupply is being reduced. We have economic growth and in a certain way, we have been fortunate because the country truly is not growing. Had that country grown, we would, of course, faced a more difficult situation. To the right of the slide, you'll see the optimization, what happened in February and April. And this will allow us to have an adequate price level. And what we are debating is how to calibrate this so that we do not have such big peaks in the future.

We go on to Slide Number 19, where we once again speak about our diversified portfolio. We have 40-60 between the free market and the regulated market. What is important here is that we have ever more data to be able to work with our clients. At the bottom of the slide, you will see that we had a growth of 66% in our free customer portfolio in the second quarter of 2019 vis-a-vis the second quarter 2018. When we speak about units, the growth is much greater and this prepares us for a much more fragmented market that we imagine will take place because of the regulatory changes that are part of the pipeline and part of the new government decrees.

On Slide Number 20, we once again speak about an increase in the free customer industry with greater diversification. And as a strategy, once again, our intention is to be very diversified in the different sectors of the economy. There is a great concentration, for example, in rubber and plastic, as you can see, but we had even greater concentration in other areas. In steel, for example, we are managing this, once again, with the intention of having the most diversified portfolio possible. And we do have a much smoother process, especially with the larger clients where we have counterparts and other systems, which allows us to be very calm to ensure that we will not face any significant impact at least in the short term. We do have this volume of resources in the short-term market and we have to wait so that we can consume some of the credits that we have in this area. I think this problem has already been dealt with adequately through the generation scaling factor and it should unlock the market once we are able to convert these credits into construction. And once again, the companies that are in veto will have to pay their debt so that we can enter a position of greater regularity in the long term, and this should happen

in the second semester. And in 2020, we do hope to have another scenario in the short-term market. We hope that we will have a more normal situation.

We go on to Slide Number 21, where we speak about our commercial strategy. We contract energy for future years. We have a greater volume of energy. In 2020 and 2021, we're over contracted already and we tend to leave some energy available because we still do not have a fully regular system. Hydrology continues to be a very uncertain element. And because of this, we need to have a reasonable volume of energy that is uncontracted. And what you can observe is that we carry out purchases of energy depending on the energy operations [ph] during a given period. Now the energy balance that use our modeling in the company. We have already spoken about our intentions once our assets are more mature. And the intention, once again, to reduce uncertainties so that we do not have an impact due to this uncertainty on the entire company.

On Slide Number 26, we speak about Campo Largo Wind Complex. We're at the end of our implementation. Once again, we're working with the assembly parts. We have the first licenses for installation. And once again, we're now setting up the process.

On Slide Number 27, the transmission line under construction for Gralha Azul. We have heard that we now have a previous license that has come from Ponta Grossa. This is for installation in the state of Parana. And once again, we're awaiting a full definition so that we can proceed with the installation in the coming two months. We should have the license approximately in the month of September.

Projects under development. Once again, no great novelties. you can see, here we have those that are in the Rio Grande do Norte as Santo Agostinho also in Rio Grande do Norte, we're working a great deal on that. In that area, we have Umburanas Phase II, as well as Umburanas Phase III with 500 megawatts of installed capacity of renewable energy in that part. And we're trying to make all of our other projects feasible through a terminal and we will be participating in the auction that will take place at the end of the year for this purpose.

Well, our financial performance, we have already spoken about non-operating revenue and EBITDA. And we should perhaps speak about the main impacts on our net income. We have an increase in net income, BRL51 million. In transmission, where we record accountability and we recognize revenue through the construction. And in the quarter, we have done this for transmission. And what we're trying to do is connect us to the costs that we have incurred on. And of course, all of this will only begin generating results, significant results when these assets come into operation.

In the short-term market, in the electrical energy trade port, we did have a drop because of the GSF. In this quarter, once again, we have a drop vis-a-vis the second quarter of 2018, the non-recurring revenue of BRL70 million that we mentioned before from a claim. And once again, this is not a recurring revenue in the quarter. And here, we have a drop because of the reduction of consumption of our clients, once again, due to the lack of resumption of our economy. We're hoping that in the coming months, our economy will become unlocked and that we will have both consumers and clients enabling us to grow

again. What we hope is to be able to enter a virtuous growth cycle, a reduction in financial assets because of the lower inflation rate. And when we account for our financial assets and hydroelectric plants for a concession that was made in 2017, the asset therefore, is based on the broader consumer price index. And we had a lower broader consumer price index in the second quarter of 2019, vis-a-vis the same quarter in 2018. And this explains the growth of our net income.

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When we go to the EBITDA changes, we had a reduction versus a drop of BRL38 million and an increase in our accounts because of our short-term pressure. That is why we are BRL47 million negative. I think these are the two main factors, the BRL147 million, less in terms of EBITDA because of the short-term market and the BRL88 million in the reduction in our portfolio in general, representing a drop of 14% in our EBITDA. Once again, this is the information listed on Slide Number 32. And a reduction in taxes, which of course, ends up being very positive. We did have the impact of several of the elements that have been mentioned, the ISS, the allocations and that is why we have lower financial results because of the drop in the interest rates, and we did need to have more capital to finance our investments and the depreciation and the coming into operation of the Campo Largo and the Umburanas parks last year, and Umburanas that came into operation this year. And that is the explanation for the figures that you see here.

On Slide Number 34, the issue of the second quarter of 2018 where we had a drop of 17.5% in capital invested. Now this is our capital invested, but without the full results of our investments and all of these figures should be shown in the coming quarters. And when we are able to fully recover these indicators in terms of indebtedness, a net debt and EBITDA ratio of 2.5%, we should also have a reduction due to the same reasons that I mentioned.

Once we have contribution for our investments, it should improve. And we're referring to a ratio, a more balanced ratio of 2%, 2.5% for the long term. This would be the ideal indebtedness level for the Company. And this of course, would then allow us to carry out further investments. And our intention is to remain at 2.5% or 3% at the utmost for net debt EBITDA and we are not going to move away from this rates as this will allow us to have the optimal capital structure, our own capital, as well as capital from third parties. And this will enable us to maintain our competitive edge, which is something that we are not willing to give up. Now the net debt change, once again impacted by the capital allocation.

On Slide Number 37. The AAA rating, thanks to the debentures that we issued and that are part of the BRL3 billion that you see here. And that will be used to do the financing and part of this will be paid in 2020. And of course, these amounts will be reduced to 1.4%. Subsequently, we'll have a very comfortable cash position. The cash position in the Company has always been very robust. And in 2022, we still have part of the debt that will be paid off and will normalize these levels in the future. And once again, we keep working on the service of our debt based on our cash generation because we also have the commitment of paying out dividends that we will refer to further ahead.

On Slide Number 38, our investments, our CapEx. Here you can see the significant investments in the last three years, BRL5 billion in 2017, BRL4.3 billion in 2018 and in 2019,

BRL5.5 billion, still a very high position. And this, thanks to the Company leverage and the very low interest rates, which gave us an opportunity.

On Slide Number 39, we repurchase the dividends. Our policy is to pay as much as possible. The management commitment is a minimum payout of 55% and we reduce the payout when there is an outside threat or when we make investments as happened in 2018. And in periods of investment, of course, we are forced to reduce the dividend, but we do maintain our minimum payout of 55% as this is our commitment taken in 2011. And as we are paying the dividend in September and as we paid dividends in 2018, we did not think there was a need to deliberate on this during the second quarter of 2019 and we're gaining some time to be able to work with a more convincing strategy for the distribution of dividends for the year 2019.

And once again, we're open -- this concludes the presentation, and we're open to your questions and answers.

Questions And Answers

Operator

Ladies and gentlemen we will now go on to the question-and-answer session. (Operator Instructions) Our first question is from Mr. Thiago Silva from Santander.

Q - Thiago Silva {BIO 17655676 <GO>}

Hey good morning to all of you and thank you for the call. I have two questions. The first refers to growth in the last two or three years. The Company has changed its focus on growth or complemented its growth first on transmission, which was a pleasant surprise. Recently, we had TAG and the expansion in the gas sector. The question is, where are you aiming at? Where are you looking at? And if we will have good news still during this year when it comes to your organic growth. And if we will have any M&A in the gas and if you're going to take advantage of the pre-sold auction or other types of sources. Once again, this is simply to have an idea of where the Company would like to grow.

The second question, once again, goes back to the issue of dividends. We observed that the discussion on dividend paying out was not part of the agenda for the first semester of the year. If you could give us some color about discussions, if there is the intention of changing the dividend payout because of the growth.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

Now a growth of strategy, of course, there is absolutely no intention to do this. We have always insisted that 55% represents a good payout for the Company, and this fully adheres with our commitments in the last few years. And 100% only if we understand that there is a sound environment without posing any risk to the Company in the future. We have simply postponed this so that we can analyze the opportunities that we foresee and that could occur. And when I speak about opportunities, we have found some

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opportunities in transmission. We have stopped being generators to be able to invest in other segments for energy infrastructure.

Now that was a decision made in a specific point of time because of the outlook of a profitable development in generation. And we understood that if we could have a more diversified portfolio in energy, the new opportunities would appear in one segment of another but the opportunity appeared in transmission at that point in time, then we had an opportunity in the generation market, in the free market and now the opportunity at gas.

So we attempt to maintain ourselves within different segments of energy, ensuring that we have a more diversified activity. Now where the investment will be made in the coming years, all of this will depend on the opportunities that we see in these three segments in transmission, in gas and in generation infrastructure. And we do have projects in several of these, as well as opportunities in several segments. And we will only choose if this represents the best choice for our strategy.

Q - Thiago Silva {BIO 17655676 <GO>}

Very well, thank you for your response.

Operator

(Operator Instructions) Our next question is from Maria Carolina Carneiro from Credit Suisse. You may proceed ma'am.

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

Hey, good morning to all of you. Thank you. I have two questions. The first refers to TAG. If you could remark, although for the time being, you do not have too many detailed remarks on the changes that have been proposed for the gas segment, which would be the potential impact for TAG and for your market, considering the information that we have up to present on the alterations made by the government.

The second question refers to Jirau, perhaps an update on the transfer process. Thank you very much.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

Good morning, Carol. This is Sattamini speaking to you. To respond to your first question on TAG. We're quite optimistic in terms of the changes that have been set forth. Looking at a market where we used to have a monopoly on the part of Petrobras, and perhaps this monopoly was necessary for the construction of the market. But because of the investment capacity, this model did not hold up.

Now, it doesn't mean that we're going to completely undo the monopoly and have a more competitive market. What people are expecting is to have more variety in the production and consumption of gas, a lower cost for gas, and of course, a growth in

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infrastructure. And opportunities will come about for investments in our own operation, in new equipment, compression equipment and substations for the inflow and outflow of gas, which means that we will have additional results, thanks to the breakdown of this monopoly. And our penetration in the segment will enable us to work with a free market or to acquire a completely new capacity to be able to leverage our position.

In our vision, we understand that Brazil has a background of contracts. We do have contracts up to a specific period. And in showing this, we will have a regulated activity that will take into account an appropriate return, as any other activity that we're used to in energy transmission. Electrical energy, there will be a regulation. And what we hope to do is gain efficiency with the system and obtain appropriate returns. The volume will guarantee new opportunities and will guarantee longevity. This is the first part of your question.

The second question refers to Jirau. As I mentioned, Jirau is still in a difficult position, and it has been somewhat difficult to respond to this because of the contracted volume. We had to guarantee a higher leverage to be able to make drawdowns from the National Development Bank, BNDES. And it does depend on the contributions of the company, and this is something that we are debating at present, to enhance the operation, especially the operation that will bring greater volumes of energy to the plant as well as other alterations, which means that there are several things that we are, once again, debating within the regulatory environment to give us greater clarity and stability.

And with this, we should be able to resume our production in Jirau. We do have several contracts that were drawn out in 2017, mid-2017, but because of this problem that was exacerbated, we're holding back a bit and waiting to be able to dispel this uncertainty. Once again, the controller is dealing with this uncertainty and we will have to discuss the value of these assets. There have been no changes in this situation and it is causing a great deal of discomfort. And once again, we are waiting before we take any definite measure.

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

Thank you very much.

Operator

(Operator Instructions) At this moment, we would like to end the question-and-answer session. We will return the floor to Mr. Eduardo Sattamini for his closing remarks. You may proceed, Mr. Sattamini.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

I would like to thank all of you for your participation in the call. We had a large number of well-known investors and analysts. We do follow-up on the list and on the questions. I would like to thank Thiago and Carol for their questions. And during the presentation, we try to respond to the questions that are normally not made during the quarter. We do try to clarify all of the questions that are posed to us, and we will be here once again in the following quarter. We hope that once again, you will participate with us and we will explain

to you the financial issues and the strategy of our business. Thank you very much to all, and have a good afternoon.

Operator

The ENGIE Brasil Energia conference call ends here. We would like to thank all of you for your participation. Have a good afternoon, and thank you for using Voicetel.

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