

Q1 2018 Earnings Call

Company Participants

- Carlos Freitas, Chief Financial and Investor Relations Officer

Other Participants

- Pedro Manfredini, Analyst
- Thiago Silva, Analyst
- Vinicius Tsubone, Analyst

Presentation

Operator

Good morning. This is ENGIE Brasil Energia's Conference Call where we will discuss the Results for the First Quarter 2018. All participants are connected only as listeners, and ensuing this, we will open the question-and-answer session when further instructions will be given for you to participate. (Operator Instructions) We should remember that this conference call is being recorded. The presentation followed by slides will be simultaneously transmitted through the Internet through website www.engieenergia.com.br at the Investors section. A slide presentation and the Company's earnings release are also available on that website.

Before proceeding, I would like to clarify that all statements made during the conference call regarding the business outlook of the Company should be treated as forecasts that depend on the country's macroeconomic conditions, on the performance and regulation of the electric sector besides other variables. Therefore, they are all subject to change.

With us today, we have Mr. Carlos Freitas, the Financial and Investor Relations Officer; and Mr. Rafael Bosio, Investor Relations Manager, who will talk about the Company's performance for the first quarter of 2018. Immediately thereafter, there will be a question-and-answer session. We would like to remind journalists who wish to ask questions to please do so by email sending their questions through the Company's press office.

It is now my pleasure to turn the call over to Mr. Carlos Freitas. You may proceed, sir.

Carlos Freitas {BIO 15364136 <GO>}

Good morning. Operator, thank you. Good morning to all of you. It is a pleasure to release the results for the first quarter for ENGIE Brasil Energia. I hope that you all have the material that we have on the site. And on page number five, we're going to speak about the financial highlights for this quarter. It was a good quarter in general with a net income

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of BRL260 million, a 16% increase, perhaps a little less than half of this due to Jaguará and Miranda that contributed for the first time in this quarter.

I would like to remind you that we took on this operation at the end of last year. These began to operate in November and they now have given us a positive contribution, Jaguará and Miranda, the regulated revenues, because 70% our quotas represented BRL113 million. The additional BRL140 that we have as growth, most of this came from a better performance in the short-term market. The average PLD increased BRL50 last year to BRL200 this year, and as was announced during this quarter, we had a great deal of secondary energy, which means that the market as a whole sub-allocated energy for the quarter and we are referring to assured energy that which the 100% or 115% once again based on secondary energy, this of course may revert during the year, but we do hope to have reasonable amount of energy this year perhaps not as strong as last year where it represented more than 20%. We're expecting 13% to 14% this year.

We also had an increase in revenue due to the increase in sales volume. The market is resuming, it already has come back, we will have significant increases in the medium term, we're referring to 300 megawatts for the medium term, and of course, this has led to an increase in revenues as well. The Company EBITDA had a growth of 18.2% for the reasons already explained basically. Now, the net income grew only "8.6%" basically because we -- the financial expenses of the Company increased. As you know, we funded a 100% of our acquisitions with the Company's net -- gross debt from one quarter to the other from March to March of this year, the net debt more than doubled.

Once again, due to the financial expenses and due to a lower financial revenue, the cash in the Company is lower vis-a-vis last year due to the acquisitions and the native investments in Miranda or (inaudible) and others that I will comment on subsequently.

Another highlight that is interesting is the slight drop in the generation of energy, hydric and solar, and that means that we have less (inaudible) to pay. And perhaps this is iconic. This quarter, we no longer have the gas plants operating, it generated energy in the last quarter of 2017. This is also another important highlight for us at present.

We now go on to the next slide number six, to speak about the highlights of the Company. I have already mentioned at the first claim, we were able to sell approximately 300 average megawatts for the medium term. And this is in line of our -- for our strategy of a gradual contracting strategy, we have seen a great deal of interest for this in the market and as mentioned we're the main player in the energy market, Jaguará and Miranda, for the first time contributed in the regulated market and besides having a 100% in the free market, it also contributed somewhat to the enhancement of our results in assured energy.

Another important point is the maintenance of the rating of the Company as a AAA for the Brazilian scale. Fitch had lowered the Company's long-term international rating to ABB. However, at the locosphere which is our source of funding for a local market and funding, we continued to be a prime company with a AAA in rating. We signed a concession contract for the transmission auctioned now in March and beginning in March therefore

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beginning as of this moment, we have the maximum term of five years. And as mentioned before, we do have the alternative of anticipating this line in at least two months.

On the following page, another important highlight, refers to the possible sale of our carbon assets, the Pampa Sul and Jorge Lacerda Thermoelectric Complex. Once again, we were negotiating with ContourGlobal as we had announced, we have not been able to come to an agreement and we are now assessing how to continue on with this process. We're going to analyze other alternatives in terms of the decarbonization of the Company's portfolio.

Yesterday, at the Board of Directors meeting, the acquisition of the 50% remaining shares of ENGIE Geracao Solar Distribuida was approved. This is a company that will tend to grow in the future. This is the way of entering the segment. And another highlight was the approval at the Annual General Meeting two weeks ago of complementary dividend representing BRL637 million that will be paid at the end of this semester. With this, we will be able to attain that 100% payout with a remaining -- of BRL2 billion, part of this paid last year, the rest will be paid this year and we will continue to attempt to pay all of this and perhaps it will come down a bit, but as you all know, our intention is always to pay as much as possible in terms of the dividend payout.

We will continue on -- in our presentation. We are going to go straight to page number 12. We have had a growth in terms of our energy. What we do is to buy and sell energy to traders simply to complement our portfolio, not only in terms of conventional energy, but also in terms of renewable energy, incentivized energy. There are periods where we sell conventional energy with a premium and then we buy incentivated energy, which we distribute in the free contracting environment because of the advantages that this allows us in the market. This mechanism represents 12% of our sales in the trading market, and if you look at the situation, approximately 50% of these revenues come from direct clients in the commercial area and 50% from PPAs and the regulated market.

We continue on. We go on to page 17, which is a slide that is worthwhile mentioning, our sales strategy. If we compare one quarter with another, we do have an important change, which is the volume sold. If we compare quarter-on-quarter, in 2020, we have 370 megas, 371 and so on and so forth, approximately 300 and some megawatts for these three years. The rest that is uncontracted in 2018 is very similar to what we had in the previous quarter. It was 12% approximately. We believe that this is a reasonable amount to be able to face the risks that we have going forward. For the coming year, we have 12.3%. We will see which is the evolution of the hydrological risk, and of course, we will inform you during the rest of this year. For the time being, it stands at 12%, and the trend is to remain at that level in the medium term to be able to mitigate the risk with specific clients and to have greater forecastability in the Company cash flow.

On page 23, it is important to also underscore the new transmission system, Gralha Azul, that we have selected for this per slot. It has a CapEx of BRL2 billion and we're reducing the CapEx -- 5% of the CapEx of Aneel and we are confident that we will be able to work with this line in 12 months with the 12 months difference or perhaps even before.

When it comes to Pampa Sul on page 24, the work is proceeding adequately. The intention is to enter into operation in the first quarter of 2019. This is a very complex work that we are proceeding with very adequately, and as I mentioned, as part of our decarbonization process, we're going to continue seeking alternatives for this asset or it could be sold now or it could be sold in the future, perhaps not sold. Once again, we're open to solutions in general.

We go to page 25, the Campo Largo Wind Complex Phase I, once again doing very well. We have already started on the commissioning of 11 wind farms each with approximately 30 megawatts, which means that we're putting 90 megas into operation until the end of June approximately. And the forecast is that the last park to come into operation at the end of the year, beginning of 2019, which means that in a period of six months between June and December, we're going to be having 300 megawatts from Campo Largo following our scheduling and somewhat below what was budgeted. The conditions are highly positive. And it is part of our work to execute and build wind farms, we mentioned this last year, we have Campo Largo in Bahia.

And on page 26, we are repeating all of this process where the Umburanas Wind Complex 360 megawatts, once again, part of the energy sold in the regulated market, and we have worked with the foundations, the wind turbines have already been built and this will come into operation at the very beginning of the coming year.

So throughout the third semester of the coming year, we will have an additional 360 megawatts of eolic energy and we have another pipeline going forward as you see on page 27. We're going to trigger all of this when it becomes worthwhile investing considering the market as it is at present. In the auction that we had a few days ago, we did not participate. We decided that it would not be worthwhile participating in that auction considering the supply and demand condition. So, once again, you'll see our pipeline that we will trigger as it becomes worthwhile doing so.

Financial performance on page 29, I have already referred to the figures for this quarter, but you can observe the trend year-after-year. It is a trend of growth. We had significant growth last year with our asset portfolio, and this year, this will continue as well.

Once again, we have rather than in the second semester, we will have solar energy coming in, on page 30, here we have a breakdown of our net operating revenue, BRL60 million, thanks to Jaguará and Miranda for the regulated environment in the short term. Part refers to Jaguará and Miranda, another part referred to the secondary market. We have the spot prices and an increase in the sales volume as you can observe on the charts as well.

When it comes to our EBITDA, on page 31, besides a 113 for Jaguará and Miranda, we have an EBITDA impact in the short-term market of BRL80 million, positive of course, not only because of the secondary energy, but because of the very active management of our portfolio that we tend to carry out. We have an increase of 6 million due to the close down of Jorge (inaudible). We also have the purchase of energy for resales of 80 million

which offsets the performance in the short term. And as I mentioned, we are increasing our trading volume to be able to complement our portfolio.

When it comes to our net income on page 32, as you can see, besides the EBITDA variation, we have two highlights here. The most important is the reduction of financial results vis-a-vis the fourth quarter in 2017 of BRL85 million. Despite the drop of the interest rate, as I mentioned, we did have a significant increase in the Company's indebtedness and another highlight perhaps a minor one, less expenses on depreciation and amortization, and an important part from Jaguará and Miranda.

In terms of our return on equity 20% and the return over invested capital as well we're growing as a company maintaining a good payout and of course good growth. And to conclude, I would like to refer somewhat more to our debt and investment part CapEx. This is an illustration of what I have already mentioned to you. A year ago, our debt was somewhat more than BRL3 billion, our net debt. It is now 6.7. Our cash has had a reduction. Gross debt and net debt are very similar. Now, we have 1.6 times EBITDA and net debt -- net debt ratio, which is a rather comfortable ratio as we have evaluated and our intention is to increase this indicator throughout this year, because part of our CapEx will be funded with debt through debt.

On the next page, here we have the bridge of the evolution of our net debt. Basically, the net debt increased between September and March of this year. It increased BRL1.3 billion, which was the amount that was paid in dividend. We paid out dividends in March, approximately BRL1 million, perhaps somewhat less and 300 and some in June and January, which adds up to BRL1.357 million, the operational cash flow, a BRL1 million was spent on investments on CapEx to pay income tax and so forth and the variation of the net debt also is what it is due to the reduction in cash.

The debt profile on page 36. We still have an expressive volume to be paid in the short term, 3 billion this year, part of this is connected to the acquisition of Jaguará and Miranda. Others are company debts, we're already focusing on this, and the illustration at the end of June will show you a shorter bar when it refers to the short-term debt.

Another very important point is the cost of the debt that has dropped. It used to represent 10% in the first quarter of 2017. At present, it has dropped to 7.9% and the percentage of CDI, which is a very low percentage as you can observe and this will reduce the average weighted cost of our debt.

And finally, on page 37, the Company's investment plan. Last year, it was 5.5 billion in Jaguará and Miranda. This year, the amount will be BRL3.6 billion, of which 2.7 will be funded through debt. These BRL3.6 billion, we have Pampa, Umburanas and Campo Largo. And perhaps minor CapEx for our day-to-day with most of this will go in Umburanas and Campo Largo. Our CapEx truly begins to decrease in 2020.

To end the presentation, we go to page 38, a yield of 8.6%, we have a record of dividends paid out. Once again, attempting to hold true to our commitment that's being a very balanced company that grows in a responsible fashion and that pays out dividends

when we see that there is not a better use for our resources and this has been the trend in the last few years and we do have sufficient debt, we should not take more. We're going to, well, we have a great deal of breadth to continue on in this fashion.

In summary, this was what I wanted to present to all of you. I would like to offer you the floor for questions and answers. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now go on to the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Thiago Silva from Santander Bank. Mr. Silva, you may proceed, sir.

Q - Thiago Silva {BIO 17655676 <GO>}

Hey, good morning to all of you and thank you for the call. In truth, I have two questions. The first refers to the price of energy. Is there any guidance regarding your strategy simply to have an idea of what you consider as being the energy price in the long term and if you will comment on the A-4, if there is room for renewable energy and if there is room to reduce the price in the long term?.

The second question, you want to grow more, you want to expand or do you prefer to work in Brownfield? What is it that you foresee as a growth strategy for the coming years? Thank you.

A - Carlos Freitas {BIO 15364136 <GO>}

Very well. Let's begin with the second comment that you made. Yes, of course, we have the intention of growing in terms of transmission and in generation and we can do this through mergers and acquisitions or not. Generally, we tend to be more competitive when we work with Greenfield, why? And because you need to manage some risks in the Greenfield projects, the environmental risk, the construction risk, the EPC risk and so on and so forth.

Then this is our core business I would say. Therefore, if we are able to manage those risks, we can obtain greater returns. If we acquire a line that has already been constructed and funded, it is very probable that we will be less competitive. Therefore, we're going to allocate our resources where we have a better chance of growing. It could be Brownfield, which is the case of Umburanas. Umburanas was not a Brownfield per se. It did not have the construction, but it already had the contract, a pre-contract with third parties that have a great deal. We took on this project and it has ended up being a very interesting deal for us. Once again, it could be a Brownfield in the future. And this is more probable than acquiring something that is ready-made.

And to respond to your first question, the long-term energy price, we continue with a vision of the long-term price of 150 to 170. This is the range that we're working with for

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the long term. For the short term, it will be above that, it could be, and this is what we expect in terms of the spot prices this year. But for the long term, it's what we mentioned in the previous quarter. The auction for solar and wind energy at lower prices, the O-4, we don't see that there will be an immediate impact in the long-term prices and we have had valid questions from many people if this will not be a trend, if there will not be a pressure in the future sale of the energy. We believe that the price of energy in the future will be a mixture of multiple issues. On the one hand, we have solar and wind energy, that could be sold in a context of availability, where the risks tend to be quite low. And with a range of options for supply, it would be one of the lowest. Brazil, as a whole, nevertheless, will not depend on solar and wind energy exclusively, it does have a very large base of electrical power that it will have for several decades still in the country and thermal energy of course.

And with this mix of sources of energy, I do not deem that there will be an impact that will reduce the prices. Now, if the trend continues as is, we will have low prices until there is a readjustment. We saw in 2011, 2012, our auctions for wind energy that had very low prices. There were problems, and well, this is a cycle that is repetitive, that is ongoing, but for the long term, once again, our vision is not to grow just for the sake of growing but to grow in a sustainable way. This is the Company vision.

Q - Thiago Silva {BIO 17655676 <GO>}

Thank you very much.

A - Carlos Freitas {BIO 15364136 <GO>}

Thank you, Mr. Silva.

Operator

Our next question comes from Vinicius Tsubone from HSBC. You may proceed, sir.

Q - Vinicius Tsubone {BIO 20139966 <GO>}

Good morning. And thank you taking my question. I would like to know, if you have a cost estimate for the plant and if you have insurance for certain events I believe?

A - Carlos Freitas {BIO 15364136 <GO>}

Good point I think. At the end of March, around March 20th we had a blackout that affected the Northeast of Brazil, the North system was isolated and during some seconds, almost one minute, there was no energy flow at the plant and eight machines stopped, some were impacted, others were even more impacted and we're slowly returning to operate with these eight machines during this month and the coming months. We already have one machine into operation, at the end of the month, we will have an additional two machines, which means three machines that will be coming into operation and then three plus three at the end of May, all of our machines should be operational.

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Regarding the second part of your question, the insurance, yes we do have insurance for this and as we work with third party, we are undergoing conversations with the government to speak about up-time and see what happens with other units. We don't expect greater effects, the material and physical costs of this problem were not that steep, it's simply a matter of time perhaps.

Q - Vinicius Tsubone {BIO 20139966 <GO>}

Okay, thank you very much.

Operator

Our next question comes from Mr. Pedro Manfredini from Itau BBA. You may proceed, sir.

Q - Pedro Manfredini {BIO 21633245 <GO>}

Thank you, Carlos and Rafael for the call. I have three questions if you allow me. The first, well, the first two questions about Jorge Lacerda. Which is the sales process of Jorge Lacerda and how did this impact your energy allocation strategy for 2018? Are you imagining a different allocation vis-a-vis other years because you decided no longer to count upon this asset throughout the year?

The second question, you spoke about alternative for Jorge Lacerda, I entered the call in the middle. If you could perhaps refer to some of these alternatives, and if an alternative includes once again negotiating with ContourGlobal who have shown interest in this asset.

And the third question, being very specific, we saw that CSP (ph) published something in May, and the sale could happen this year. Is this part of the radar, it's part of what you are planning on doing, you spoke about M&A and perhaps you could have something to add, CSP through this new contract has new capacity and it will have uncontracted energy going forward, if this is part of your strategy or if your strategy continues to be to focus on wind energy and Jaguará and Miranda. Once again, which is your growth strategy going forward?

A - Carlos Freitas {BIO 15364136 <GO>}

Thank you, Pedro, for your excellent questions. We begin from the beginning. Jorge Lacerda and the allocation of energy, the Lacerda Complex until it is -- it is sold continues to be ours. In our energy allocation for this year, we have considered that we are owners of the complex wholly ours. This is a process that takes time, we have to undergo that process of negotiation. And in practice, even if we have come to an agreement, the transfer would not be made this year. What is more important nevertheless is that this asset is potentially under sale. And up to present what has been happening fully does not make sense. Jorge Lacerda continues in our portfolio this year, it continues to be part of our portfolio into 2019 and other years. We do know that if we sell Jorge Lacerda and this is the more probable case we could carry out a PPA in transition during two or three years, we would still have energy that would be ours and this will be a scaled transition based on a contract which would be very positive for us and will also be very positive for the buyer.

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So, when it comes to the allocation, well, alternatives, we mentioned during the call and as I mentioned, we are at present back at the negotiating table, thinking about our next steps. I still cannot remark who this would be with and how this would be. We have agreements that we cannot comment on, but we're not standing still. We are evidently assessing alternatives not only for Jorge Lacerda but for Pampa as well. When it comes to (inaudible), our stand continues to be as it was at the beginning of the year. CSP has received an additional 20-year extension and this makes it ever more interesting, we're waiting for the -- well, this would depend a great deal on the conditions in terms of their liabilities and whatever exist at present at CSP. Once again, this is part of our radar. But it will depend on how complicated are now we consider this business.

Q - Pedro Manfredini {BIO 21633245 <GO>}

Thank you very much. And simply to conclude this, when this process began last year, did you assess this asset, and I suppose that since then as it was part of your radar, you have had sufficient time to assess all of the possibilities. I think these are some of the critical points that are part of the purchase of CSP or do you have to wait for that public notice first, when you have time to carry out a more in-depth analysis considering that, that public notice should be out in 30 days.

A - Carlos Freitas {BIO 15364136 <GO>}

The only thing I can repeat once again is that it is in our radar. I cannot give you any further details. Thank you very much.

Operator

(Operator Instructions) At this time, we end the question-and-answer session. I would like to return the floor to Mr. Carlos Freitas for his closing remarks. You have the floor, Mr.Carlos Freitas.

A - Carlos Freitas {BIO 15364136 <GO>}

I would like to thank all of you for their time and for their confidence in the Company in the last few years and should you have any further doubts or comments, we're at your entire disposal. Thank you very much once again and have a good day.

Operator

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

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