Q3 2018 Earnings Call

Company Participants

- AntÃ´nio Carlos VÃ©lez Braga, General Manager of IR
- Bernardo Afonso SalomÃ£o de Alvarenga, CEO, President of Executive Board & Director
- Daniel Faria Costa, Unknown
- MaurÃcio Fernandes Leonardo, Chief Officer for Finance & IR and Member of Executive Board
- Paulo Eduardo Pereira GuimarÃ£es, Unknown
- Ronaldo Gomes de Abreu, Unknown
- Unidentified Speaker, Unknown

Other Participants

- Unidentified Participant, Analyst

Presentation

AntÃ´nio Carlos VÃ©lez Braga

Good afternoon, everyone. My name is AntÃ´nio VÃ©lez. I'm superintendent of Investor Relations at Cemig. We now begin the broadcast or the webcast of the financial results referring to the Third Quarter 2018 with the presence of our Legal Director, Neila Maria Barreto Leal; our Financial and Investor Relations Director, MaurÃcio Fernandes Leonardo JÃºnior; the Director of the Management (all interests), Daniel Faria Costa; superintendent (of control), Ronaldo Gomes; and corporate finance Management Director, Paulo Eduardo Pereira GuimarÃ£es. The webcast can be followed on phones 55-11-121-880-055 or 2188-2188, or our website, www.cemig.com.br.

For initial remarks, our financial director has the floor.

MaurÃcio Fernandes Leonardo

Good afternoon, everyone. Thank you very much again for once again dedicate your time to follow Cemig. We had one more challenging quarter. But in accordance with the guidance that we have publicized to the market. Also, the conversations we had with the market agencies, risk agents, banks, investors in Brazil and abroad. You can see the adherence of the results with everything that we've been telling you about which for us is great value which shows the acuity in management transparency and relationships. And also this is one of the reasons that led us to postpone this call for a few days. So without much further ado, I'm going to give the floor to our colleagues. In the end, I will come back, remark you on some highlights. And also, we will be at your disposal for the Q&A part of this call.

Very well. So now beginning the presentation that we have prepared to talk about our results this quarter.

On Page 3, we have the highlights as for the gross revenue in the Third Quarter was BRL 9.7 billion and it's up 16.3% from the Third Quarter '17. The net revenue was BRL 6.3 billion in the quarter, representing a 21.7% increase. You see the magnitude of gross and net revenues of the nine months of the year BRL 25.6 billion and the gross one and the net BRL 16.8 billion.

Our expenses in terms of PMSO continue going down in the Third Quarter, BRL 723 million, 1.5% cut relative to the period of '17. So we're talking about a real reduction of more than 5%. So we had quite expressive reduction which goes to show our effort and commitment of our operational efficiency and the cost of personnel which fell by (14.2%.) In the nine months of the year, the expenses reached BRL 2.1 billion with the reduction of 10% in the same period. The EBITDA was BRL 902 million in the quarter, up 122% -- 123% relative to the Third Quarter of 2017 considering the nonrecurring divesture we had in that period. All of the adjustments we're measuring here are (relatively evidenced) in a table as an annex to this presentation. Our EBITDA in the first nine months reached almost BRL 2.8 billion, which goes to show a clear trend towards reaching the guidance that was announced May this year. Our net profits, we adjusted without the effects of the hedge reaches BRL 300 million in the Third Quarter. And in the nine months of the year, it reaches BRL 998 million in the nine months.

About the next slide, coming to(the representation) of our interim accounting information, I'm going to ask our controller, Bernardo, to talk about this data.

Bernardo Afonso SalomÃ£o de Alvarenga {BIO 20057432 <GO>}

Good afternoon, everyone. As everyone knows, yesterday, the company (represented) the quarterly presentation of the second and Third Quarter of Cemig Holding and Cemig D. And these adjustments (were used to the regulation liabilities). As for the assets and the liabilities, they are made up during the process. During the period of the effect of the tariff review, readjustment and the reapproval of this review, all of these assets and liabilities were reported biannual without any differences with regard to the values constituted by the company. But after the approval those values, because of those assets and liabilities and the tariff -- represented in the tariff of the company, these are registered results because they were considered -- included in the tariff readjustment because of the provision of the company these values that were being lowered beginning 28 of May. The values that were being transferred after the results were not correct vis-Ã -vis what was approved by the regulating agency. However, in spite of being identified by the company, we rectified that after the presentation on the quarter information related to the Third Quarter. So it was necessary to represent the quarter information so as to guarantee more -- in a greater transparency and a more adequate view by all investors who are interested in the company to better estimate vis-Ã -vis our results. In this way, we readjusted our revenues -- our gross revenue of BRL 326 million cumulative in the second and third, which in terms of fiscal effects represents an increase of net of BRL 138 million. This is a one point in time issue and the other results are going to -- and the other measures are going to prevent the occurrence of such an events later. So these are representation that is totally publicized in our Explanatory Note 2.3 of our quarterly information. Now I will give the floor to Eduardo, superintendent of our financial management, to talk about our Eurobonds.

Paulo Eduardo Pereira GuimarÃ£es

Good afternoon, everyone. In terms of capturing our resources, it's important to notice the resources of the opening of Eurobonds offer in 2017 by Cemig GT, even though we have mentioned this in the last conference call the subsequent event. But it's worth stressing again. Using the opportunity of the market, we decided to reopen the operation of Eurobonds by capturing $500 million more in order to use those amounts to pay the debts that were due this quarter 2018 and beginning of 2019. It was a very successful operation. We have a (yield of below the one that has given worse results -- actually better,) using the perception of risk by our investors showing that it has decreased. And in 2017, we had a hedge operation in order to protect the company because of exchange rate variation. And we followed the same (guide) lines as we did in 2017. So making the company protected in a way that between the floor of BRL 3.85 was the value of the rate of the dollar. And the ceiling of BRL 5. So we are comfortable in this range. And in terms of cash flow, the hedge operation gives the correct protection to the company in terms of currency exchange variation.

Moving to Page 6, I'd like to comment something that was in the objective, that was communicated to the market in September this year, that everyone knows that the Eurobond admission places the company laying on many restrictions in terms of payments and use of resources of the company that admitted it. We have some franchises to respect and in September 2018, in order to meet the needs of needed cash of Cemig D, we had a mutual operation for the distribution of Cemig D totaling BRL 630 million. This mutual operation was approved by ANEEL and it was done in order to meet the immediate needs of the company. We have already communicated. There was an expectation in a very short run Cemig D to return those amounts to Cemig GT. So now in November, the excess which should be $119 million in November, we already -- Cemig D made the part payment of most of this value equivalent to $138 million. Now with this payment, we have recovered our condition of compliance vis-Ã -vis the restricted conditions present in the Eurobonds. So this is no problem any longer.

And now moving on to Page 7, I would like to reinforce also that all of these measures that the company has made since 2017 with the rolling of the debt, with the assets -- selling assets in order to generate a moderate resources to pay off the debt has been received by the rating agencies. And throughout 2018, several rating movements show this better perception of risk vis-Ã -vis our capacity of clearing off the debt in our private (quality). As you can see, since December 2017, we had a significant evolution in our credit notes. And now we can say that today, we are happy to say that on a (national international) scale, the company has the title of investment grade. So this has to do with the reception and the perception that the rating agencies have of the improvements that have been made through the credit policies of the company. Later on, we're going to talk about the Cemig debt in a little more detail. But now I'm going to give the floor back to Velez to conduct the presentation.

AntÃ´nio Carlos VÃ©lez Braga

Thank you for your explanation. Now moving on to Page eight and to talk about the evolution of our divestment programs. These events that were already announced but it's important to highlight that the conclusion of the disposals offered in the telecommunication assets, we had a tender on August 8. It was very successful and the final amount of the proceeds of BRL 655 million, well above the minimum tender amount was BRL 350 million and well above the net value of those assets which was $250 million. So these transactions were finished in (a successful) way, all of the conditions were met so that in the beginning of November, Cemig already received the amounts relative to the sale of those assets and again the proceedings will be included in the Fourth Quarter results.

Now moving on to the next page, Slide #9, the suspension of the valuation of the public offer which was being considered by Light company. Cemig then through an RME sold 4,350,000 shares which are part of the controlling block of Light. Then we got BRL 64.5 million and the sum total of our interest of the RME in Lepsa -- Cemig, RME and Lepsa now are less than 50%, 49.99%, the sale was effective yesterday.

Now moving on to the figures of the results proper, we begin with the electricity market. Consolidated represented an increase of 0.9% in the Third Quarter 2018 as compared to the Third Quarter 2017.

Looking at the details of what was the market in Cemig D. In terms of total energy build, the sum total for the final consumers and those transported to free customers, the energy billed increased 3.2% as compared to the Third Quarter '17. And the highlight was the power transported to the free customers (in the concession area), which was 6.3%. A great part of this has to do with the migration of free customers have increased their consumption by free customers in the commercial sector and migration of some of them, which until then were captive consumers of Cemig D in the Third Quarter '17 and are no longer such.

Now in this way, the energy sold to final consumers had an increase of 1% with the (organization) which is highlighted by sector of consumption and the increase of 1.6% in the residential sector, 2.3% in industrial and a fall of 0.6% in the commercial area, increase of 3.5% in rural and a total reduction of 2.2% in others which is basically public lighting.

As for the market of Cemig GT, energy sold by Cemig GT compared to the same quarter 2017, the total volume sold increased 0.7%. But there were a few changes especially in the types of consumers which are served by Cemig, an increase of 7.9%. And so the 3 quarters a reduction of 9.6% to other consumers (especially).

Moving on to the next page then, we're talking about the Cemig D losses. They had in a way total losses or reduction, a small reduction on the margins from June '18 to

September '17. There was a greater reduction from '17 -- from September '17 to September '18, more than 13.76%, September '17 to 12.99% September of 2018. Keeping in mind that in the tariff review, the coverage of technical losses (increased) so that the gap today of total losses over regulatory -- total regulatory losses is 2.99% and 11.75%, the regulation growth in terms of total losses. In terms of non-technical losses, which is basically explained on the deficit in our losses, the losses, even though there was a significant reduction, September '17 to September '18, they had a slight increase from June '18 to September '18. We still are fighting this strongly and we believe that after the economic recovery, these losses will improve greater -- greatly in the next few months. Speaking here about the operational expenses, I'd like to give the floor to Leonardo JÃºnior to talk about the evolution of PMSO which have been quite favorable to us.

MaurÃcio Fernandes Leonardo

Cemig as in the last presentations told the market that we have (a trend and its) commitment to operational efficiency and cost reduction. I would know this very clearly in our quarterly information, how the costs of the company have been reduced vis-Ã -vis the previous years even if without adjustments for inflation. In 2012, we had the GuanhÃ£es operation and we noticed that the PMSO were managed (by the company's in the right way,) an expressive reduction of personnel expenses of BRL 51 million, only BRL 54 million vis-Ã -vis an increase of third-party services, offshore services and this increased by BRL 29 million is related to the increase of the activities of operation and maintenance so as to improve the quality of service that we offer. So the reduction of cost does not imply the reduction of quality. And especially the cost of materials has to do with the purchase of fuels for the production of our electricity. This does not reflect on the cost because it generates more revenues. So it's an expense related to revenues. So it does not reduce operational efficiency. It will have a reduction of BRL 56 million. This is a constant area of concern of us related especially to the maintenance of labor situations and estimated loss and accounts receivable. And we have been taking action in order to reduce our expenses recorded with estimated losses in these accounts receivable (from our mostly loyal customers). So an historical analysis of our PMSO in the Third Quarter 2017 was greater than the one that we presented in '18 without mentioning adjustment that we've talked about having to do with fuel. Even without inflation readjustments we have been showing every quarter, an improvement in its efficiency without compromising the quality of services. Continuing in our presentation, we're going to talk about consolidated EBITDA. I'm going to give the floor back to Velez.

AntÃ´nio Carlos VÃ©lez Braga

Thank you very much, Leo. On Page 13, we have the EBITDA evolution in the nine months of the year. And again (this we had) strong evolution in the nine months. In cumulative nine months of the year, as I said, we're close to BRL 2.8 billion. And in last year, it had been BRL 1,941,000,000 so that we had an increase of 44%.

The EBITDA in the Third Quarter 2017 had been BRL 101 million. And (regular deals) and the other adjustments to EBITDA would have been BRL 405 million as we compare which is not recurrent. When you see this level of EBITDA we had in the Third Quarter '18 -- with the Third Quarter '17 values with the Third Quarter '18, even then you see a strong growth of EBITDA of more than 120% in the period coming from operational efficiency, increase of revenues and tariff reviews and asset equivalents having to do with our interest.

On the next page, we also have the evolution of the net profit, consolidated net profit. Our net profit for the first nine months of '17 had been -- would have been BRL 431 million. And when compared to the nine months of '18, we have seen a growth of 131% reaching practically BRL 1 billion which is a significant growth. And we also have a very significant growth in what would have been the results of the Third Quarter '17 adjusted, minus BRL 50 million. And now in '18, it reached a level of BRL 300 million that is consolidated in the quarter only. So it's a very significant evolution. And now we see that this evolution has been taking place in Cemig D in a constant regular manner from every quarter also because of our efforts to have operational efficiency. And the Cemig GT without the adjustments adjusted for the effects especially of our hedge, we hedge there especially because of the conditions of GSF. And in an accommodative way, they remain quite aligned with what had been expected. I'm going to give the floor back to my colleague, Paulo Eduardo to talk a little bit about our debt profile.

Paulo Eduardo Pereira GuimarÃ£es

Thank you, Velez. Talking about the debt, now the schedule of the dates still were very much better than in the previous years. We were able to elongate the main (part of time) for our debt from two years to four years on average at present. This would give an ability to generate cash that we have in Cemig GT and D in the next few years. And Slide 18 saying that these financial compromises were going to be supported by cash generation and (debt) capturing. But I can say that in the next few years we are going to be geared towards managing this debt using the better quality of credit of the company and therefore having cheaper debts in order to pay for the more expensive debts. We're going to go into this phase now which is that of promoting the elongation of the debt and the reduction of its cost. It's important also to say that as a subsequent event, which is not shown in this schedule, that using the availability of cash, Cemig GT has done, after the Third Quarter, payments of important debts. We have liquidated BRL 741 million in CCBs which had higher cost. And we also anticipate BRL 132 million in debentures that would be due at the end of the year. Resources available with the admission of Eurobonds and the indemnities paid by -- received by Cemig GT, we had a better use for those announced. As for the computation of the debt, everyone will see the important perception of the debt in U.S. dollars. But as I had mentioned previously, this U.S. dollar debt has been postponed in a very attractive manner, transforming the interest rates in the CDI percentage, according to CDI percentage which represents the credit quality of the company. And we are protected in our rates within the band of exchange variation, which we understand to be quite safe. And lastly as for the cost of debt, you can see the evolution by in the chart that we are from '17 -- 2016, we have a large amount of debt in the short run -- due in the short run. This improvement of quality has been noticed in the evolution of our debt, which has reached now one (digit). So representing a much better perception of risk of the company by analysts.

Now I will turn the floor to Ronaldo.

Ronaldo Gomes de Abreu {BIO 20244891 <GO>}

On Slide 16, on the cash flow of the company, we (think that) the first year generation revenue of cash generated by operations BRL 776 million net after payments of interest of BRL 104 million. So this was the year in which we received values of the generation of assets of (inaudible) but we received indemnities of BRL 1 billion -- BRL 1.1 billion. But that was the period, when the cost of electricity after (May) after our tariff reviews were high. And the costs are lower. But during the drought period, the company had a volume of expenses above what have been predicted in the tariff that was over BRL 1 billion which made up for the value of indemnities that we missed. This was the great expense that we had and it's going to be big part of the NASDAQ readjustment. So it was important even with the pressure of cash because of the cost of electricity generation. We generated a positive cash of approximately close to BRL 1 billion in order to guarantee our investments of the period BRL 790 million from January to September 2018 related basically to our activities in this (area by the company). As for financing activities, we had also to highlight that between what we amortized and our original annual capital resources had a negative value of BRL 62 million from January to September, we reduced our debt besides the payment that we've made of BRL 64 million in interest. So we had a very (acrobatic) -- a very balanced -- a well-balanced cash flow. Now our financial Director, Mauricio Fernandes, for his final remarks before our Q&A part.

MaurÃcio Fernandes Leonardo

Now gentlemen, I think it was made very clear by the figures that we presented to the investors about the progress the company has been making. And I think it's nice to look back. A year ago, the company was obtaining a reprofiling of the banking debts and after a long time clearing up the situation at that time. And if you compare, for example, that a little less than a year ago, the company captured Eurobonds abroad. And after hedge. And it had 150% CDI operation of $500 million that we had recently, Paulo explained to you at the cost of 125% CDI. We're not satisfied, still not satisfied. But that was a very important decrease. And why has this happened? Thanks to the perception by the market and market in a broad sense that we should understand agency -- risk agencies, financial institutions, investors both in Brazil and abroad (and certainly it has been made every effort) that was worthwhile which is to get close to the market. Constantly, our executives have been with you, giving you details and explaining the results of the company. It's important to talk about this coherence as to what the company has promised back then is being delivered now even when momentarily we cannot directly explain to you so that you can continue following and believing in our management. I would even say that when you look at the scenario that the country we live in now, it's very promising, because since these years, management, like a private company, searching for efficiency and with better relations with the market agents in a very transparent manner. So we're now -- even though we're in the process of transition for new administration at the state level and the country level, the company is concluding its revision of (the annual planning) and its budgeting with very challenging goals. And we are even creating the -- define one committee for operational efficiency made up by our executives, many ongoing projects so that they can propose to the top administration of the company, efficiency measures that will place Cemig on an even better level than it has been enjoying now.

And now last September, it's important to say that for the first time around. And this is historical, Cemig D has reached a regulation apex, in large numbers, 1,895,000,000 coverage. And we operated 1 9 6 5. So it's 97% service percentage. We were in the process of obtaining the complete coverage and from now on to continue taking this by another and next year. And up until next year, we will increase -- we will assess the regulation EBITDA. So Cemig D transmission is already there, explained already and it's already referenced and it continued to be so. So our budgeting is going to reflect all of those challenges.

And it's important to say that the admissions that the company has had is actually we were going in a very adverse scenario. The great operational risk in emerging countries, not properly Brazil but Brazil was among them, let's not forget the financial economic crisis and political crisis the company is going through. The state of Minas Gerais is no exception. The state is also facing a project crisis. The unemployment rate of the country is major. And even then, the Cemig has been presenting a very robust growth and figures every quarter, indicate clearly that we are on the right way this year. Only this year, Cemig D has already captured -- subscribed more than 2,600,000,000 which reflects the commitment of the company to reinvest to make the company even more solid in order to face adverse times. And you remember that at the end of next quarter, we told you that Cemig had identified a very strong pressure on and around its cash because of the -- and the GSF has fallen. And '18 also was worse than '17. It's one of the worst years in a series in events and we can't present results because let's remember that individually (it' s) (the greatest and the largest distributor in the country. So all of this here is impressive anyway.

One, few more things about the divestment plan, we have already achieved the sales of Telecom and other divestments. We have worked with Light, it has not worked out momentarily. But the company's bylaws have been changed. It's already made ready for the next step. Dr. Daniel is here with us who has (headed) that in the interest of directorship. So we have to stress the quality of the partner that is evaluating the purchase. Nothing is discarded. That was a very respectful relationship that was built with little issues that are still on the table and (can maybe with this professional purchaser that has been planned). It's still going strong as the other companies that we follow. It has reinforced capturing of BRL 550 million impressive because one year ago, we had difficulty to reprofile the debt. Now the bulk of this operation only in this country is almost 3x as much (as more offers). First-line banks, all of them. So this shows our recognition and the strengthening of those important agents. The company has been doing very good work with the labor administration and our legal director Neila Maria Barreto Leal in the management of personnel. And we are now reverting the provision of the labor liabilities. So we'll have challenges but this is already being targeted.

Now we're talking about the PMSO and the behavior of the Cemig shares. Of course, the political scenario has had a strong interest both in terms of the country, in terms of Minas Gerais itself. But it's also important to say that Cemig is a state-owned company, both nationally -- level -- the state level and at a national level that actually has been valued more. And so we have a recognition of the market of the way with which the company has been managed. So this valuing (improvement) in the AGLs that we're have in the United States. And also Eurobonds, just to give you an idea of (9 14), it was being sold at 7.5. Now there was an increase this year. The dollar has changed but this indicates a trend. And we believe that Cemig shares have acquired -- have come to a new level. So having said that, I open the floor for questions and I thank you for your attention.

Questions And Answers

A - AntÃ´nio Carlos VÃ©lez Braga

And we have the first question.

Q - Unidentified Participant

I have many questions. First one has to do with Light. Could you specify what the details were -- actually what were stumbling blocks because of that? There was -- now it was canceled. So what are the problems actually? Second, we were about to provide more details about the payment to the state government of the sales tax by CMS. And there was a independent committee of how was it done.

A - MaurÃcio Fernandes Leonardo

Vladimir, it is Mauricio. So first, I'm going to answer about ICMS and Daniel will answer about Light. Obviously, ICMS, there was an operation that the state has laid out a decree by means of which Cemig will have to advance 75% of the sales tax which we will have to pay. We made the legal consultations and Cemig has made the payment but I am going to explain if you look at the decree, it is very self-explanatory. Thus, in next November, there is going to be a settlement that were for two months that were addressed. The first month and in January, moving in dollars of the second half that was addressed. So as you said there is no return of money. So in November, we did not pay ICMS. So in December, we don't pay ICMS for the collection of this money as described in the decree. So we made this analysis, a legal analysis. And we concluded in favor of payments. So our company cash is already captured. There's no problem. About Light, Daniel is going to give you an answer.

A - Daniel Faria Costa {BIO 20562390 <GO>}

Vladimir, thank you for the question. Just as an aside, as Mauricio has mentioned, yes, we had our process of structuring the transaction and we -- and to sum it, it was the change of the social bylaws of Light with the authorized increase of capital, equity increase, all of the necessary changes to continue the process of public offer. The main point was evidently, as in every transaction that involves this kind of public offer appeal. There was no agreement about the price because of the difference of expectations. But this interval was quite small and this trend is quite small. And as Mauricio has stressed, the mandate of our board is to continue selling our interest in Light. And your (international) Light, I don't want to talk for or Light for them. But in terms of cash flow, Light is adjusted. It elongated its debts. There were some problems of very high due dates in '19 and '20. And this admission of the restructuring and the reduction of the leverage also continues being targeted by the Board of Directors of Light. And we follow up -- we are going to follow up. So we have a good expectation for the next months to take up again operations that will include not only the deleveraging of Light and of the selling of our interest.

Q - Unidentified Participant

(inaudible)

A - MaurÃcio Fernandes Leonardo

I didn't hear your name. As for technical losses -- non-technical losses that is, the issue is you see the rate of unemployment we are in a state in which the public powers has actually divided the payments of the salaries, has actually divided the payment. We have a budget in supplementation in order to intensify our billing measures and debt collection. So we decided to cut the energy. This operation was effective three months -- two months ago. And it has to do with outsourced. And we see an important and major reversal. As our economy also improves, there is also going to be reflected upon our nontechnical losses. It's also important to stress that Cemig historically never had problems of that nature. So this brings light for -- that things are actually and they are occasional and they're not actually permanent. So I'd like to say also to fight electricity thefts. Cemig has gone somewhere but the establishment was closed and then we are cutting supply of energy to people who are actually stealing energy from us. Sorry, I cannot hear the questions.

Q - Unidentified Participant

(inaudible)

A - Unidentified Speaker

Sorry. But the quality of your audio is not good. So I cannot hear the questions. So I cannot translate them.

A - MaurÃcio Fernandes Leonardo

Francisco, thank you for your question. At the time, I don't know exactly. We have not identified anything wrong. We're going to see if there was something having to do with the adjustment last June. (As soon as we do we) will give you our feedback. Thank you. Another question.

Q - Unidentified Participant

(inaudible)

A - MaurÃcio Fernandes Leonardo

Well ladies and gentlemen, this is Mauricio. Just for the final remarks then and to thank you once again on behalf of the executive directors and the board of this company, the executives who are sitting around this table here. Of course, every quarter is a time of great anxiety and joy to be able to report to you the things that we have done. And to the risk agencies, thank you very much for following us. You're very important to us. The financial institutions, both in Brazil and abroad, very important and the assistance you give us. Our stockholders and our bond purchasers, thank you for believing in Cemig. And I hope we could see you again in order to report the next results. So I am at your -- we're still at your service. Thank you.