

## Q3 2015 Earnings Call

### Company Participants

- Henrique Freire, Chief Financial Officer
- Miguel Setas, Chief Executive Officer

### Other Participants

- Carolina Magluci, Analyst
- Paulo Ferreira, Analyst
- Thiago Silva, Analyst
- Unidentified Participant

### Presentation

#### Operator

Good afternoon. Welcome to EDP Energias do Brasil Conference Call to discuss the results of the Third Quarter 2015. All participants are in a listen-only mode. Later, we'll open a Q&A session, when further instructions will be given. (Operator Instructions) This presentation together with the slides is being simultaneously broadcast via Internet on this website [www.edpbr.com.br/ir](http://www.edpbr.com.br/ir). There you will also find the release and the results for the Company.

Before moving ahead, EDP do Brasil would like to highlight that certain statements, made during the conference call, regarding business perspective for the company, as well as projections, operating and financial targets regarding its potential growth, projections based on management's expectations regarding the future of EDP Energias do Brasil. These expectations depend on the economic state (inaudible) the country, performance and regulation of the electric industry, in addition to other variables and therefore are subject to change.

Let me now give the floor to Miguel Setas, CEO and IR Officer for EDP Energias do Brasil to host the presentation. Mr. Setas you have the floor..

#### Miguel Setas

Good afternoon everybody. Let me start thanking you for attending EDP Energias do Brasil call for the third quarter of 2015. In this call, we also have the presence of our CFO, Henrique Freire and our Financial and Investor Relation Director (inaudible). And first of all, let me justify the change in the time of the call, which was projected for 11 AM and was moved to 2 PM upon my request. This morning there was a meeting called by the General

Director of ANEEL for the presentation of the main lines on the proposals of GSF risk and my presence in that meeting was really important. That's why I preferred to delay this call.

Having said that, let me propose to go directly to the presentation of the third quarter. Page four, I'd like to remind you that here we have five slides, where we firm our strategic focus. So they are consolidated and they are the main reason for attention for the Company and I would like to illustrate now that the most important thing which happened in the third quarter regarding these five aspects was the following.

The first aspect, regarding what we found to be the strategic focus of the Company as a hydrothermal operator and associated to this movement in the portfolio, is the operation that you can see in the third quarter was the sale of Pantanal Energetica, which is the company through which we operate two small hydro plants in Mato Grosso do Sul. This businesses was closed at BRL390 million and is now fulfilling [ph] other measures so that at the beginning of 2016, we can close this resection.

I'd also like to highlight the reason for this transaction, which was the optimization of our portfolio in a region where EDP no longer operated, we no longer had distributor and so the assets were no longer located there. So Mato Grosso do Sul was really not very relevant. So these HPPs no longer had synergy in the transition nor in the generation business. And this was the reason for this transaction. Second aspect, as I told remind you that we've always speak that one of our strategic focus was the execution. In the case of the two plants, which are currently being built, Cachoeira Caldeirao reached the 92% completion and Sao Manoel reaching 83%.

On slide number five, moving on, as you can see, we already have works to complete the plant concreting the final blocks of the spillway and concluding the left bank and civil works about to be concluded. From the electro-mechanic perspective, we are in a final phase preparing unit number one, which will be ready for commissioning in the next few months. So this is a good indication and the projection I had given you of Cachoeira Caldeirao is ever more concrete as we come closer to the end of the year.

Regarding Sao Manoel, you also see on page five, an important advancement of works, you see that excavations of the power house and spillway structures were completed. So geologically, the most complex works have already been accomplished and now we are completing the main structures of the plant manufacturing the first electro-mechanic equipment. It was also important during this quarter to have the BRL185 million of BNDES, which was pending for funding this operation.

On slide six, regarding the third aspect of our strategic points, I'd like to comment about Pecem I power plant. On the left hand side, you see the evolution of the plant availability, we are closing the third quarter with 87%, 11 percentage points higher than 2014. And also a financial performance in line with the operating evolution.

Before talking about financial performance, I like to say that in operating terms, we had a (inaudible) for 20 days to maintain machine number two, they're much in line with what we had already projected and this occurred in the period that was projected for it. From the

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financial perspective, you see that in 2015, we have BRL29 million EBITDA and this shows us that the same finished the year with results beyond our expectations.

I also say that Pecem the current results is around BRL300 million EBITDA in the first year of its operation. Therefore, in the third quarter, we already have around BRL309 million in the first nine months of 2015. Of course, if we compare to the third quarter of 2014, there is this effect of provisioning of doubt [ph] in the amount of BRL237 million, which -- if we exclude this impact, the third quarter of 2015 is much healthier than 2014 than the same period in 2014. So we have completed the operating building, the regulation and we are now concentrating in improving the financial conditions of Pecem funding.

On page number seven, I like to say a word about the fourth point of strategy, which is operating efficiency. As you can see on the slide, the evolution of operating indicators, you see the performance of EDP Escelsa, which posted 8.12 percentage point drop. It dropped its (inaudible) and so a drop in these indicators of technical quality. The losses that you can see, the maintenance of Bandeirante's losses are very close to regulating figures and here you see the work fighting losses concentrated on municipalities and in segments of customers where this loss is more felt. So our projection is to close the regulating losses and to reach zero very soon. And we keep on recording a favorable evolution of 0.12 percentage point drop in terms of EDP Escelsa losses. We'll reach the end of the year close to 0.15%.

On page number eight, I would like to highlight the dimension, the fifth dimension regarding the mitigation of risk factors. In the context of tariff increase, I could not but mention the level of bad debt and default. On the left hand side, you have the default and this chart shows the relative evolution of default compared to total sales in the last few months. So you see a rise in foreign absolute terms and in relative terms you see an improvement due to our efforts to hold the evolution of this variable. So we have been working together with (inaudible) changing the collection rules and holding the default rate which is yielding some effects.

Next to this, we have the provision for bad debt at levels which we consider normal for an operation of this nature. Of the third quarter, you see that at Escelsa, this level was more or less at same level. It was kept at the same level as 2014. At Bandeirante, we went from 0.49% to 0.74% PDD over growth revenue. And we also have a number of measures to hold default levels at under control I'd say. So the main message here is that, we are being affected by the tariff increases, but these standards or these parameters are very much under control.

Let's go to slide number nine, where we talk about energy risk. So what we have today in our portfolio is the GSF risk. On slide number nine, you see that between 2016 and 2018, the level of energy without contract between 11% and 13%. I remind you that we have already been close to 19% and 20% in the last 30 years, but gradually, we've been reducing this position.

So today with 11% in 2016, we have flexibility to cover GSF risk with this energy not contracted or to make decisions on adhering to other mechanisms proposed by ANEEL in

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the government to mitigate GSF. So we have some possibility of reducing the position or crystallizing it and also and place it here, this energy of energy (inaudible) which those bilateral contracts with distributors will close on January 13, 2016. It has already been sold to EDP Comercializadora. The last of these sales was 142 megawatts at -- for a four-year contract at BRL113 million. So within the next four years, EDP is reselling this energy in bilateral contracts using this position to manage the energy portfolio.

So this is what I have to tell you. I'd now like to turn the floor to our CFO, Henrique Freire and then I'll come back at the end of the presentation to talk about the expectations.

## **Henrique Freire** {BIO 19117781 <GO>}

Let's move on to slide number 10. At the financial level, this is one of the key points of the Company mitigation of risks and maintaining a high cash level as a strategy for funding. During this quarter, we had an emission of under EXCHANGE, the Law number 4131 of the Central Bank of Brazil from Citibank for EDP Bandeirante. This in accounting terms, in real was BRL75.5 million.

In this start you see that there was an increase in our net debt of 2.3% from December 2104 until September 2015. This 2.3% which increase is explained by Pecem and also because Pecem brings BRL2.1 million and during this period we had a CapEx, a consolidated CapEx of BRL246 million and then BRL475 million in investments. So Pecem BRL133 million, from Cachoeira and Sao Manoel, an installment of BRL42 million.

In terms of net debt EBITDA, you see the evolution to 1.6 times of net debt EBITDA ratio. However this ratio has been backed by accounting gains from purchasing the same, excluding BRL885 million, the net debt EBITDA would be 2.3 times. Of course, this is also impacted by the accounting gains that we had in Pecem. So again, if we were to exclude this effect, we would be talking about our net debt EBITDA ratio of 2.3 times, but with still low level.

Talking about the debt profile, on the left-hand side chart, 50% of our debt is consolidated. Our profile excludes projects like Jari, Cachoeira, and Sao Manoel. So 50% indexed to CDI during this period. If we compare the third quarter 2014 to the third quarter 2015, we see an increase of 3.3 percentage points, so 11% to 14.3% and the long-term TJLP long-term interest rate at 3.5% [ph] have an impact on our financial results. Part of this is in dollars, it has to do with the same financing.

There is a swap protection of course, but this will capture an increase in cost, because there is a mismatch in the swap and in the debt as we will see in a little while. Let me remind you that in the first two weeks of October, we closed the fourth issuance of debenture BRL892 million with the issuance of three series. These series were, first one, BRL664.3 [ph] million with the term of three years at a cost of (inaudible), a second series at six years. The second and third series are series, which are ventilated by CapEx. This issuance was BRL180 million around that. IPCA plus 8.3201 PA and the third series BRL48.1 million IPCA plus 8.2. The effect was with Sao Manoel already mentioned with an addition of disbursement of BRL185 million from the BNDES.

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Now, let me talk about the gross margin on slide number 11. On slide 11, we see the evolution of the gross margin of distribution. It went from BRL406 million in the third quarter of 2014 to BRL420 million in the third quarter of 2015. There are some effects. On the one hand we have the B parcel with IGP-M adjusted BRL90 million, variation in parcel B due to the rate increase inflation adjustment, an X factor. And also BRL37 million Itaipu energy purchase. This was totally mismatched with the energy which was over contracted by the Company. And then an accounting effect of BRL97million, which will have a negative impact on our financial results. It will increase the margin and then increase financial costs for the Company. In terms of generation, the highlight is close to Pecem. We see a gross margin increase of 248.1% to BRL203 million. The plant is under civilization. So we expect this amount to be stabilized, in terms of GSF, if at all the GSF will now be lower than last year. The spot price has gone down, so we have financial cost for GSF. The impact is BRL147 million. But this semester, we are positioning the GSF impact. So in accounting terms and results terms, we are accounting for this. In terms of marketing, we had a drop of 50.7% gross margin, which is the impact of price reduction.

And now moving on to slide number 12. You see an analysis of PMSO. The first chart shows the values, the manageable amounts. An increase of 31%. It looks like a high value but if you see in a more careful analysis, it means a positive evolution. First, we had the inclusion of Pecem during this period bringing BRL35 million to PMSO. Last year, this was not consolidated and this year it is. So this effect and the lower and side chart shows the impact of Pecem. The variation between quarters were 14.4%. So you see the movements here and these values are under control and if we were to exclude the provision for bad debt, the variation between quarters was 6.3% below the inflation in the period. So with the third quarter of 2014, this was very low because there was the effect of some impact with clients, so the comparison is not balanced even though there is now an increase in the spot price. Without considering this effect, this would be only 6.3%. I'd also like to highlight the distribution. If you look just at distribution where we concentrate most of our costs, we would see that this increase would be 5.6% only. So somehow we can absorb this with a very tight control of costs, remembering IPCA of 9.5% and other results.

Slide number 13, you see the analysis of EBITDA, which reached BRL587 million, so from BRL318 million to BRL507 million in this quarter. A gross margin of BRL315 million, minus less than BRL66 million PMSO. BRL33 million was for Pecem [ph]. So this all makes our EBITDA to grow 85%.

Regarding the net results, you see a drop in the income for this period. I'd like to say that the main factor to highlight here is the financial results. Its variations of around BRL200 million. So, against the third quarter of 2014, BRL122 million are from the inclusion of Pecem and from the BRL869 million come from factors which are already considered in the consolidation of last year. So from the BRL80 million, BRL37 million come from Itaipu, which is for accounting purposes but it is not for activity of distribution. Also in this period, the reference rates move -- these higher values. I would also like to say that the BRL122 million of Pecem is a high amount due to the dollar swap. We have a debt in dollar. The swap is valued at the market and the debt is valued at the date of the quarter. So there is a mismatch between the evolution of the debt. So when there is a depreciation of real, there is an impact, in this case is an impact of BRL180million, which is significant, but it has

more to do with the accounting mismatch in terms of the date for the figures than the cash itself.

Now I would like to give the floor to Mr. Setas, who will talk about the tariff review of EDP Bandeirante.

## Miguel Setas

Thank you Henrique. To wrap up, I would ask you to go through pages 14 and 15, and especially on page 15, as I think you all are familiarized with the data on tariff review. Let me just talk about the highlights. The first highlight is about the B tranche BRL791 million as you see. This is an evolution of 4% regarding the B tranche, which we had in 2014. And this contrasts with a reduction of 20% which we had recorded in the third factor of tariff review between 2010 and 2011.

If this effect was very much mitigated and it has to do with the price of walk [ph] and this brought a stabilization to tranche B. I would also like to mention that in the case of losses especially, commercial losses, we had a mitigation of the loss curve in the third cycle. It had a reduction of 1.4 percentage points, 1.4 percentage points of reduction every year and this went to less than 0.5 percentage points. So our loss curve is much more attenuated, in this case a better perspective to close the gap between our current curve and the regulating curve.

In the lower part of the chart, I think this is important to highlight the importance of EDP Bandeirante and the demonstration of our regulating assets. In the third cycle, the difference between the bases which was the target of the valuation and the approved base was 9%. So around 10% of the base of the approved base is not accepted. So if this is reduced, you are talking about less than 1%. So BRL1.6 billion and BRL1.70 million is the variation.

So in 2011, the elements which provoked a revolution of the improved base have been corrected and today we are in a situation very close to zero which is our objective. This is a very important and positive element for our economic performance. So this is the end of my presentation. I'd just like to mention that from our perspective, results were very consistent during the third quarter. Consolidating the Company's performance along the last nine months or the first nine months of 2015 rather. Our strategic focus was on the five dimensions that I have been communicating to you during the last month and we are very happy with the results reached on the third quarter of 2015.

So with that I'd like to wrap up and open up the floor for questions.

## Questions And Answers

### Operator

Ladies and gentlemen, we'll now start the Q&A session. (Operator Instructions) Carolina Magluci [ph], JP Morgan asks the first question.

## Q - Carolina Magluci

Thank you very much for the opportunity. Miguel, my first question has to do with the hydrological index. What are the expectations in terms of evolution in timing. Second one is about the 29 plants. It has been postponed to 25th and I'd like to know how the funding for this auction is?

## A - Miguel Setas

Thank you for your questions. As I said this morning, ANEEL gathered the companies to present the main lines. In principle this is going to be published today, so it's early to talk about the final position. There were some positive evolutions in this proposal that's going to be published; a 10% discount in 2015 for example. There is a possibility of a partial coverage of GSF. So, operators may choose to cover GSF in a percentage, which is different from 100%, you can be at 98%, 97%. And this would also bring risks down.

The risk premium is now 100% covered BRL9.5 per megawatt hour, above what we had originally expected. So we'll have to analyze on a case by case basis, plant by plant the new rules. I think in general, the impact is positive, but right now, we're not in a position to say something can create about orders. There may be different decisions for new plants and plants which are already operating with regulatory assets or liabilities. So there may be different decisions for ATR and ACL plants.

So, the result of this analysis will be a decision with a different perspective. Depending on the plant's characteristics and on the fact that it is under -- in the regulated market or not. In the next few days we are going to have more information and other opportunities to discuss this topic with you. Regarding the auction, I would like to restate that which we have already said, we focus on the execution. We have two works under construction, Sao Manoel and Caldeirao. We are at 50% of conclusion and important turnaround for the results of the Company. So our focus is still going to be to complete these projects and to optimize our operation, both in the generation side and on distribution.

## Q - Carolina Magluci

Thank you very much.

## Operator

Next question Thiago Silva from Santander.

## Q - Thiago Silva {BIO 17655676 <GO>}

Good afternoon. Thank you for the presentation. Miguel, you talked about energy sold at BRL170 per megawatt hour. Could you tell us a bit more about this deadline and how is the liquidity in this spot market?

## A - Miguel Setas

Thank you for the question Thiago. Let me just correct. You said BRL170 and I am telling you BRL160. I am sure this has something to do with my difficult accent to understand, but

the amount was BRL160. So the energy sold to EDP Comercializadora was a four-year contract with a flat price of BRL160. This allows EDP Comercializadora to have a margin. We are reselling this energy, we are reviewing prices in the market and the free market around 16 and 17, between BRL170-BRL180 per megawatt hour. This is what we are doing. So we are selling this energy partially.

As you saw, in the previous slide, slide number nine, we have 120 megawatts to an average 11% of energy without contract at a lower value. So this reselling is going to be at a higher margin than what we bought.

## Operator

Our next question Paulo Ferreira from Bradesco BBI.

### Q - Paulo Ferreira {BIO 18941383 <GO>}

Let me go back to one aspect of the proposal, mitigation of GSF risk. Could you explain, if there was any important change in the free market. If I understood you right, I think the most important change was in the regulated market. What about the free market? Was there any important change according to your perspective? And regarding leverage, could you give us some guidance in terms of where the leverage will be at the end of this year especially not considering the important accounting impact that we had in the second half of the year?

### A - Miguel Setas

Thank you for your question, Paulo. In the previous question I was focusing on the regulated market. In the free market also we'll see some changes according to what we saw today in ANEEL. But in the free market also ANEEL's proposal deserved better level of criticism and intervention by the Company. So I consider that this proposal may be reviewed prior to its final version. I do not exclude this possibility at ANEEL. But in principle, the free market, we have mandatory buying of energy for a period.

This energy would have to participate in another auction. And if the GSF supported by the Company and the value of this energy is negative, we have an extension of the construction time and this is in order to provide an NPC zero. The way it was presented today, this was the reason for a lot of comments and there might be some changes as I said prior to the final version. This is what we understood after the comments that were made. In terms of leverage, I would like to ask our CFO to answer the question.

### A - Henrique Freire {BIO 19117781 <GO>}

Thank you for your question. During the presentation, I said that we have the ratio of 1.6% times. We would be at 2.1% times if we excluded the other factors. So we have any updatation, we'll have a final leveraging. This is something that is for consultation of the banks. You're talking about an emission of BRL354 million to BRL355 million of additional leveraging, but we don't foresee other events by the end of this year. In global terms, we are very limited in terms of leveraging. As a general guidance, we are talking, we feel that

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up to 3 times the ratio of net debt to EBITDA would be a comfortable level for this kind of business, for this industry. Not sure whether I did answer your question.

**Q - Paulo Ferreira** {BIO 18941383 <GO>}

Thank you very much for your answer. So when you talk about BRL300 million to BRL400 million, would this be going to holding for accumulated? What would be reason?

**A - Henrique Freire** {BIO 19117781 <GO>}

About 60% would be retained by EDP and 40% by (inaudible). This amount would be up for capital reduction already approved by ANEEL. We also have accumulated results if we distribute it. So this is how we're going to distribute the amounts to the shareholders.

**Operator**

Our next question comes from (inaudible) Credit Suisse.

**Q - Unidentified Participant**

Good afternoon. Let's talk about free energy. You said that it is now being sold. We're going to see about the best strategy and the rest of the energy without contract. But we notice that there is this balance of many megawatts for next year from Pecem. Do you intend to maintain the group to compensate to offset this balance? Are you leaving anything reserved for this? All of this availability will be more for the structural average for the 60 months which will still be in place for the next -- for the near future. What you intend to do with this free energy from now on?

**A - Miguel Setas**

Well, regarding Pecem, the parts under contract are mostly covered in the short term. The other strategy is, this is not associated with Pecem. And Pecem is positioned without under contract, served to cover the short-term market. You buy and you liquidate in the next month.

**Q - Paulo Ferreira** {BIO 18941383 <GO>}

Thank you very much.

**Operator**

Our next question (inaudible) from UBS.

**Q - Unidentified Participant**

How does the EBITDA reported by the distributors of BRL220 billion [ph] was better than BRL170 million reported before? I understand the impact on the Itaipu but the range is over contract, but there was a drop in demand of 3% quarter-on-quarter. So, please explain.

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## A - Miguel Setas

I'm sorry, could you repeat your question?

## Q - Unidentified Participant

I'd like to understand how the EBITDA in this quarter, BRL220 billion, [ph] how is it better than BRL170 billion last quarter? If you consider the drop in volume and if you consider the tax and accounting effects and also the offer contracting of Bandeirante. So how did you manage to make this EBITDA grow quarter-on-quarter?

## A - Miguel Setas

I'm not sure whether Henrique understood the question, but I think the main difference in terms of the quarter EBITDA is the regulatory assets which were not accounted for last year or last quarter. This quarter is marked by these two differences. Pecem, consolidation and the recording of regulatory assets which are very relevant and which were not in 2014. This is the main reason for the change and offsets the negative impacts. I was referring to the second quarter of this quarter. The difference between the second quarter, this year and the third one. There you have the new tariffs. So we have the adjustments with impact of 2% and this was contingent upon a tariff adjustment. Thank you.

## A - Henrique Freire {BIO 19117781 <GO>}

I am thinking about the over contracting of Bandeirante. This had a very important impact, but we can't give you this explanation in detail. There is some other non-recurring effects which should also be taken to consideration. So we can answer your question later in detail.

## Operator

(Operator Instructions) Our next question (inaudible) from Itau BBA.

## Q - Unidentified Participant

Good afternoon, Miguel and everybody. You've been talking about the focus on the execution on new projects and also the challenge of continuing, and maintaining the distribution business, some challenges in the south of Bandeirante and so on. So we have a very high leverage due to the Pecem corporation and all, but we're seeing some market players -- well, the M&A market is a very warm up, it's hot especially or somehow also due to the sale of a power plant.

My question is, in case there are some opportunities and if there are any opportunities for M&A in terms of generation, would the Company be willing to bid even though I know that you're focusing on the execution and considering the high leverage for the next quarters?

## A - Miguel Setas

Thank you for your question. I think that the answer couldn't be other ways, of course we have to analyze all the opportunities we have in the market because some interesting

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transactions may come up. But as I've been saying, the focus is to execute our projects is to absorb and consolidate the same. And so the opportunity to participate in one of these transactions is a low possibility, because we want to keep our strategic focus. So the company management, of course, needs to analyze all the opportunities that come up in the market. But due to the strategic focus and the leveraging, I don't see that it would be something easy to occur. It's not a favorable situation for this to occur. Thank you.

## Operator

(Operator Instructions) If there are no more questions, our conference for the third quarter results of EDP Energias do Brasil now come to an end. Other questions would be answered by the IR department. Thank you very much for your participation. Thank you for attending and have a very nice afternoon.

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