

Q2 2019 Earnings Call

Company Participants

- Alexandre Nogueira Ferreira, Regulatory Affairs and Strategy Director
- Mauricio Perez Botelho, Chief Financial Officer
- Ricardo Perez Botelho, Deputy Chairman

Other Participants

- Andre Sampaio, Analyst
- Carolina Carneiro, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to the teleconference for the second quarter of 2019 results. The audio for this conference is being broadcast simultaneously through the Internet in the website at ir.energisa.com.br. In that address, you can also find the presentation available for download. We would like to inform that during the company's presentation, all participants will only be able to listen to the call. We will then begin the Q&A session when further instructions will be given. (Operator Instructions) We would also like to inform that the conference call is in Portuguese and will be presented by the company's management, and for the English conference, there will be a simultaneous translation available.

This conference call contains forward-looking statements that are subject to known and unknown risks and uncertainties that could cause the company's actual results to differ materially from those in the forward-looking statements. Such statements speak only as of the date they are made and the company is under no obligation to update them in light of new information or future developments. They depend on circumstances that may take place or not. Investors should understand that the industry conditions and operational factors may have an impact on the future results of the company leading to results that are materially different.

I will now turn the conference over to Mr. Mauricio Botelho, who will start the presentation. Please, Mr. Mauricio, you may proceed.

Mauricio Perez Botelho {BIO 2105889 <GO>}

Thank you very much, operator. Good afternoon, everyone. I would like to thank you for your participation in this conference call for the second quarter results. We have Ricardo

Botelho, President of the Energisa Group; Alexandre Nogueira, who is Regulation, Vice President; Fernando Maia, Regulation, Vice President; and we also have Claudio Brandao, Director of Corporate Finances; and also Mariana Rocha and Bruna Alvarenga with the Investor Relations team.

I will present some slide on the results, and then we'll open for the Q&A session. I would like to remind you that as done in the previous quarter, in the last two quarters, in the case of operational items, we have include the companies that were recently purchased. Also for the financial aspect, we're going to present the pro forma values, which do not take into account the acquisition of these two companies.

So now, moving on to slide number three, I will go directly to the highlights, which is the adjusted EBITDA totaling BRL899 million for the quarter; BRL1.8 billion in the first half. Regarding the results, even though the profit was BRL119.9 million in the first half, in the second quarter, we had losses of BRL8.9 million. This negative result include recent results of the acquisitions of Ceron and Eletroacre. These companies negatively contributed with BRL153 million in the quarter, but in terms of the pro forma as such taking into -- not taken into account these two companies, we had a net profit of BRL151.5 million. Later during this presentation, we will provide details of other effects, which had an impact on the Group's results.

And so moving on to slide number four, we're going to talk about the energy market. Sales had an increase of 3.5% and Brazil only grew 0.3%. For the first quarter, we grew 4% compared to 1.7% for Brazil in general. In this first half, all of our distributed -- distributors, I'm sorry, had a positive growth. The highlights for this quarter were in Energisa Mato Grosso, EMT, with a growth of 6.5%, influenced by the residential segment. (technical difficulty) market and the distribution was greater because of the industrial sector with a reduction of 0.5% which was followed by some technical shutdowns in the cement and fertilizer industries.

We're now moving on to slide number five and we will talk about some of the highlights which were our efforts in the low income sector. In 2014, we started demanding more information from benefited consumers and we observed that some of them were just flinching it and there was the potential to expand default payments and so because of this, and in addition to the campaigns -- to the reregistration campaigns we had, we started using analytical tools, processing public data, and we're able to expand the number of eligible consumers. You can see in the graph slide that we had an increment of 92,000 clients recorded as low income between June 2018 and June 2019. With the highlight through the recently acquired concessions with an increment of 67% in Ceron and 43% in Eletroacre.

And then in the next slide, slide number six, on the left side, you can see the electric losses, and you can see this indicator was 13.55% considering all of the Group's distributors, and 0.25 percentage points above the regulatory target. If we do not take these two into account, then this would be 11.50%, in other words 0.25 percentage points below the regulatory target.

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The highlight for EMT. Even though there was a slight reduction in the quarter, it had the second largest reduction when compared to June 2018, which was 0.82 percentage points. This Energisa Mato Grosso continues meeting the regulatory target, and we are actually 0.16 percentage points above the target. Energisa Paraiba had a slight decrease when compared to March 2019, and there was an increment of 0.45 percentage points when compared to June 2018. And this is explained by increment in non-technical losses. We are trying to overcome this with an additional plan to fight theft and was implemented at the end of last year and intensified in 2019.

Energisa Sergipe was once again below the regulatory target because of all of these actions to fight energy theft. Eletroacre follows below the flexible regulatory target with Ceron is approximately 6 percentage points above the regulatory target. We adopted different measures to overcome this situation. Since these Utilities had an increase in losses since August 2018 and then in June 2019 there was a decrease when compared to May, indicating the first outcomes of these measures in the region.

And we are now going on to slide number seven with the service quality indicators. So, you can see that except for Ceron, all other distributors were below the quality regulatory targets. Many of them continue breaking their own historical records in terms of quality indicators as it was the case of Energisa Mato Grosso, EMT, and Energisa Paraiba, EPB, and you see Energisa Sergipe and Energisa Paraiba in FEC. Energisa Mato Grosso have the best performance of the group in terms of quality with a reduction of 4.18 [ph] hours in DEC, and 3.04 times in FEC. Energisa Tocantins was ranked as number two, with improvement of 4.16 hours in DEC and 3.02 in FEC.

In Ceron, there was an increase in DEC when compared to June 2018. And after the acquisition, Energisa prepared an indicator reversal plan and the fact that the DEC in May and June presented a significant reduction when compared to January and April, reinforces the trust in the measures that were adopted.

And now we will focus on the explanations about the companies not taking into account, Ceron and Eletroacre -- without and we had an increment of 0.4 percentage points in the quarter and 2.2% in the first half both below the inflation rates for this period.

I would like to pass off, the increment in personnel is explained by the salary readjustments and increase and the number of companies in the group, especially in the holding, as a result of incorporation of new activities to the Shared Services Center, such as invoicing and the activities of IT system development.

On the other hand, we had a decrease in labor expenses, labor penalties, especially in Mato Grosso do Sul, there was -- the service line reduction was impacted mainly by expenses with M&A and the holding Energisa S.A., and also by the reduction in Energisa Tocantins, which is explained by the inclusion of technical change.

And now we're going to move on to slide number nine, and talk a little bit about the pro forma consolidated after that. Without taking into account Ceron and EAC, it was BRL915 million in the second quarter and BRL1,873 million -- I'm sorry, BRL1.873 million in the first

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half with increases of 40.2% and 30.4% respectively. And if we do not take into account, after the increases there was an increment of 43.9% in the quarter and 32.8% in the quarter.

And I would also like to highlight that except for the non-recurring effects detailed in the attachment of this presentation, the EBITDA for the quarter would have grown 51.4% in the quarter as a result, mainly the increase of BRL289.8 million in Part B of the distributors. In the first half, this would be pass on to 42.7% improvement.

Also in Slide 10, we compare the regulatory EBITDA and the reported actual EBITDA in the last 12 months, and the highlight here would be the approximation of Grupo Rede which currently is 37% above the regulatory target.

And now we're moving on to slide number 11, and we will talk about the net profit in the quarter. You can see that there was a growth of 46.5%. Without the non-recurring effects also mentioned in the advancement of this presentation, we had the mark-to-market impact BRL194 million without any effect for the company's cash. And if we exclude these extraordinary effects, the pro forma net profit in the second quarter would have been BRL316.4 million which is 213.8% above what was recorded for the second quarter in 2018. And then for the year, the consolidated net profit totaled BRL464.7 million with an increment of 89.1% when compared to the first half of 2018 or BRL219 million higher. And if we do not take into account the EBITDA effect and the mark-to-market of our net profit in the quarter would have been 192% higher than the first half of 2018, in other words, BRL671 million.

Now we will talk about debt. And the net debt include the debt acquired with Ceron and Eletroacre, totaling BRL11.9 billion, which includes the sum of BRL736 million regarding the mark-to-market of the debentures of Energisa S.A., and also the debt balance associated to this bonus of approximately BRL620 million.

We believe that there will be a conversion or some effects of this bonus, which would lead to a reduction of 0.3 times the indicator in the net debt or EBITDA. This covenant indicator was stable in 2.7 times. And as mentioned in the past quarter, this indicator takes into account approximately BRL1.2 billion resulting from the combination of businesses for the purchase of Ceron and Eletroacre which were taken into account for the fourth quarter of 2018. And if we do not take into account these amount, the indicator would have been 3.6 switches pretty comfortable according to what was negotiated for this year which would be in the order of 4.5 and 5 times.

And then in the next slide, we're going to talk about investments that we have closed the quarter with BRL759 million, and the first half with BRL1.304 million. In the transmission segment, we invested approximately BRL70 million in the quarter and BRL120 million in the first half.

In this next slide, we're going to talk about the transmission products. The ones that were included in April 17, in this case, we have Energisa Goias and Energisa Para 1 which started operating in September and October of 2018, respectively. Both projects have

progressed 71% for Energisa Goias and 48% for Energisa Para. The negotiations with the owners have been almost concluded and regarding Energisa Para 2 which is the lot purchased in June 2018, the construction started last month, actually, the month before last, in June 2019. And the physical advancement of this block is of 10%.

Energisa Tocantins transmitter, which was purchased last year, we have filed a basis project in July 2019 and part of the studies to obtain a prior license were also obtained in the same month, the environmental license. Together these four blocks had an ARP of approximately BRL188 million with an estimated CapEx of BRL1.5 billion.

So I would like to conclude, and I'm available to answer eventual questions and answers.

Questions And Answers

Operator

Thank you. We are now going to start the Q&A session. (Operator Instructions) Carolina Carneiro from Credit Suisse, would like to ask a question.

Q - Carolina Carneiro

Well, thank you for the call. I have two questions. The first one is, you included the pro forma PMSO for Acre, but I would like you to share with us, how the integration is going for the Acre regarding the indemnization of labor and all of the liabilities so that we can have an idea what the management course would be for these new utilities?

And also the second question is, that you said very interesting numbers on the number of clients, which are qualified as low-income clients and have been registered. I would like to know exactly what is the potential of these registered utilities? There are more clients that may be reclassified for the next quarters in Rondonia and Acre or if this process of identifying clients has already been concluded? Thank you very much.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

We're going to share the answer, Caro, if you can wait a minute. Ricardo will answer you.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

Thank you, Carol. So, in response to your question advance the pro forma PMSO and the measures regarding Acre and Rondonia. What we have nowadays and we have different markets for the future, but regarding the indemnizations from the beginning of the year, we had 30% of the labors and companies joining these plans and they are going to leave the company by December. We also internalize inspection and activities with the quality improvement plans, we have different implementations in place. So all of these measures are ongoing. And we are probably going to have a better picture for the whole year. But it will be better at the end of the year and early next year, when we will be able to see all of the effects in terms of EBITDA. Now to evaluate performance, the best time would be around the first quarter of next year. There is a natural curve of implementation, and also

when all of the personnel lead the company. I hope I have answered your question on low income re-registration.

Q - Carolina Carneiro

Good afternoon, Nogueira. How are you doing?

A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

This is a dynamic process as demonstrated, and we're always comparing the list of re-registration. And based on our planning, if we taking into account, the new registries and the ones that have been cancelled. By the end of the year, we will have 80,000 or 90,000 that may be registered. This is an estimate for the purpose of planning, but our expectation is that we'll be able to double it.

Q - Carolina Carneiro

Thank you very much. It's clear now.

Operator

The next question is from Andre Sampaio from the Santander Bank.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good afternoon. I would like to ask two questions. The first one has to do with the tariffs and I would like you to give us a little bit more details of how the asset basis is going. And I would also like to you to talk a little bit about the negotiation between Tocantins and ANEEL.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

In response to your question, Andre, and Alexandre Nogueira?

A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

Good afternoon, Andre, and good afternoon, everyone. Regarding your first question for Acre and Rondonia, in June, we concluded the inventory and the assets that were included, and we are now in the process of preparing the reports, which will be delivered on August 29. There are no problems regarding this process.

About your second question, the Tocantins renewal, the process is ongoing. And this was chosen as ANEEL, the process is ongoing, and there are some steps to be developed this year, but there are no risks.

Q - Andre Sampaio {BIO 19422379 <GO>}

I would like to ask one additional question. So do you understand that the renewal will be just like it was for the other asset?

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A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

Yes, exactly.

Operator

The next question is from Luiz Pecanha [ph] from Banco Safra.

Q - Unidentified Participant

Good afternoon. Thank you for the call. I would like to know about the payment of the BRL500 million and even so you had a negative fee adjustment. In May 2019, there was a reduction of 7.4%. Was that done to compensate anything?

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Alexandre Nogueira will answer your question.

A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

Luiz, good afternoon. Regarding Ceron, we had a positive increase and in March along with a review of other companies because of our adjustments we also included part of the readjustment of 7.4%. And so, of course, that this will be readjusted in the next readjustments. So it was just a delayed readjustment. Yes. Part of the adjustment was not approved, and there was a reduction because of CR and so whatever was deducted will be taken into account next December.

Q - Unidentified Participant

Do you have -- what will happen in the next readjustment, I'm sorry, in the next reduction in terms of Ceron and Acre?

A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

Well, it will depend on what will be approved and it's directly related to that.

Q - Unidentified Participant

So you don't have an estimate yet?

A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

No, we do not have an estimate available yet.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

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(Operator Instructions) Thank you. I would now like to turn over to Mr. Ricardo for his final remarks. Mr. Ricardo, please move on with your final remarks.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

Good afternoon. I would like to share with you another year of good results for Energisa, and on July 3, of the 11 categories with over 500,000 [ph] we were finalist in eight and won four of the four categories that were analyzed for companies with up to 500 consumers, we won two award. Energisa Nova Friburgo was considered and won the award of best distributor in Brazil once again for the category of up to 500,000 consumers. And then the other companies who are in the group were Energisa Paraiba, Tocantins and Sul-Sudeste.

I would also like to give you some more information about the integration plan for Ceron and Eletroacre. And as explained by Alexandre, we have achieved results on the inventory of the assets of all of the companies including a large mobilization we were able to carry out 100% of our inventory and provided -- will provide by the end of the month a full report to ANEEL.

Everything has been taken into account, registered and will be included in the most modern platform available for this segment which will enable us to be able to reduce drastically the number of hours. In September, we will conclude the inspection by ANEEL, and in December, we will have a restructuring. And as we mentioned the intervention plan is ongoing. Regarding transmission, we are very happy with the advancement of the construction as mentioned by Mauricio. And we also anticipated the entry in operation. If we keep the same construction rate, we have some loss, which will be made available in December. And due to strategic reasons, we do not know exactly where and how.

We wish you all a good afternoon and nice weekend. Thank you for your attention.

Operator

Thank you. The teleconference is now concluded. Please hung up now.

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