

Q3 2020 Earnings Call

Company Participants

- Antonio Carlos Velez Braga, Superintendent of Investor Relations
- Leonardo George de Magalhaes, Chief Officer for Finance and Investor Relations
- Reynaldo Passanezi Filho, Chief Executive Officer, President
- Unidentified Speaker

Presentation

Operator

Ladies and gentlemen, thank you for waiting. Welcome to the Conference Call for Cemig's Third Quarter 2020 Results.

Antonio Carlos Velez Braga {BIO 16813855 <GO>}

Good afternoon, everyone. I am Antonio Velez, Superintendent of Investor Relations of Cemig. We now start Cemig's third quarter 2020 earnings conference call and webcast with the following executives: CEO, Reynaldo Passanezi Filho; our CFO and IR Officer, Leonardo George de Magalhaes and all the other officers in the company. You can follow this transmission by the phones in Brazil 55-11-3127-4971 or a number in the U.S. 1-516-300-1066. And also on the links available on our IR website, ri.cemig.com.br.

For the initial remarks, I would like to turn the floor to our CEO, Reynaldo Passanezi Filho.

Reynaldo Passanezi Filho {BIO 15054064 <GO>}

Good afternoon, everyone. It is always a great pleasure to be here with you to bring the results of the company for this third quarter and the year and the year-to-date.

Considering what we have been looking for and what the company has been able to deliver, we have results that are consistent and sound and they do show the company's resilience in the pandemic and obviously, also they show very positive perspectives in terms of the growth recovery. So I will just comment on a few topics and then we'll go deeper on then, but first, sound and consistent results in financial area.

We have our adjusted EBITDA and consolidated EBITDA much higher than 2019 BRL3.6 billion with an EBITDA of much higher for this year. Net income adjusted and consolidated also over 2019, almost 12%, BRL1.7 billion and gross debt is controlled. Our net debt over EBITDA ratio is of very little -- much lower ratio it's 1.55% and that implies in a better rating and also allows us to have a very comfortable situation nowadays in terms of over BRL5 billion in cash. So we are able to celebrate here.

FINAL

We are lower the regulatory levels. As we have mentioned already on Cemig D. We have been working hard in PMSO to reduce expenses in PMSO and even our EBITDA, our regulatory EBITDA has a very good result. This is a mark that is very few times the company has been able to reach that number, but this is now we have a variable year with investments and execution. And I'm sure that we will be able to reach our goals.

About operating income, we also have sound results, a recovery of our load -- I'm sorry to interrupt. We have seen in the national integrated system that recovery in the national load, but it's no different here. We are 3% up over September for Cemig D, and also we have growth in the free market and a higher growth. Since March of 2020 and the year-to-date, because of the period of the pandemic, we had a different behavior, but now we see a gradual recovery of the load and that's very important in order to ensure that we have new contracting levels and that will allow us to grow as well. The recovery also of the leverage -- I'm sorry, of the levels and that's an average that is in line with the target of 2020 that is much higher than what we had in the most difficult period, which were April and May.

And finally, and when we talk about DEC and FEC, the average audit duration, we have 9.3 hours and this is also a very good result, because the regulatory DEC is lower than 10. So we are lower than the regulatory levels. So I believe these are the main messages here.

We have sound results and like I said, we do have a company that is very resilient and we are ready to recover our growth. Our CapEx is in line to what was planned and in spite of the crisis, we have made a few adjustments and the investment program is broad and is still ongoing. We have a positive effect in our partnerships. Light, TAESA just published their results. They do have positive results. And therefore, there was appreciation of their stocks and that also strengthened us.

So we are also having positive results in generation with the GSF law approval. We will have a gain that is very significant in terms of extending the average term of the concessions. And something else that I would like to highlight that can be applied to Cemig GT, but also for all the other subsidiaries or the companies as well where we have interest at that can be applied to North Energia, TAESA, Light. We do have a very positive perspectives of value gain and this is subject to that is very special for the electric sector.

We did have also a tender notice and we do have a whole series of projects in the wind farm generation over 2 gigawatts that if we have 1.7 gigawatts, we have to think about expansion. And we have to work on the mix and grow our own energy and bring down outsourced energy and we can then strengthen our commercialization area. So these are the main highlights.

So just I would like to confirm what we have been saying, we do have an ongoing recovery process. The results start to show, but we have a private rationale for decision making, always aiming to generate value for our shareholders and provide consumers and the society, the quality product at an affordable price. These were my initial remarks and we are available to take your questions at the end of the presentations. But when we look at

it, the consistency of the figures and the adjustment that we have been able to do are really bringing us good results.

Unidentified Speaker

Thank you very much, CEO. So now let's turn to the presentation itself. I would like to ask you to turn to Slide number 3. Our CEO already mentioned some of these highlights, but I would like to stress that about operating efficiency, that for the first time, Cemig Distribution in the nine months of this year already has operating expenses, lower than the regulatory limit in BRL127 million vis-a-vis our leverage, we -- 1.55x our net debt over EBITDA. That's very comfortable, specifically about our cash generation. The third quarter EBITDA for 2020 was up when the adjusted comparison, the 24%, reaching BRL1.3 billion in the third quarter.

And because of our leverage and our debt profile and also thanks to our debt cost, the rating agencies also recognized our credit quality and have improved our ratings in different ways, and I will go into the details in the next slide. We continue identifying and intensifying actions to prevent power losses as well as delinquency. This year specifically was -- because of the pandemic, a very challenging year, but we are still working hard to prevent our losses and delinquency.

And very good piece of news is that thanks to all our sustainability initiatives that we care so much about, Cemig was for the 21st consecutive year chosen to be part of the Dow Jones Sustainability Index, which is one of the most -- one of the oldest recognitions of the financial industry about sustainability practices in the world. So we are very proud to say that we are in the 21st year, again part of the Dow Jones Sustainability Index.

Now turning to Slide number 4. We have here the ratings of the main rating agencies Fitch, Standard & Poor's and Moody's. Fitch and Moody's just recently elevated our investment grade and you can see that on the screen, both in the domestic scale as well in the global one and the Standard & Poor's has revised our perspective for positive, and that means that maybe next year, we also can have an upgrade in our credit quality and our credit ratings.

Now turning to Slide number 5. We have some collection indicators. We see how the collection over the year was affected specifically in the months of the second quarter, April, May and June. But starting in July, specifically in August, we had a strong recovery of our collection and also improved our delinquency rates. We have to remember that during the pandemic, we had restrictions, we were not able to perform disconnections. And in August, the disconnections started happening again, and from August through October, we had over 235,000 disconnections.

And as you know, this is the main initiative to fight delinquency. We also should highlight that in the third quarter of this year, we had a reversal of BRL231 million of the ADA provision. Thanks to negotiation with the Minas Gerais state government. Therefore, the ADA of 2020 in the year-to-date for 2020 is in BRL46 million up to September.

FINAL

And now turning to Slide number 6. We have here the execution of our investment program. So far, we have already invested BRL1.2 billion, that is consolidated. Out of those 80% were directed to distribution, Cemig Distribution, 6% were allocated to transmission -- I'm sorry, 6% were allocated to generation, 10% transmission and 5% were capital contributions and acquisitions, small acquisitions that we had throughout the year. So that's the breakdown. We had BRL76 million investments in generation and transmission, BRL121 million and strengthening and upgrading and that is translated in the APR, Annual Permitted Revenue, and distribution up to September BRL960 million and about capital contributions and acquisitions. We had BRL20 million of capital contribution for Cemig C [ph] and we acquired part of Centroeste BRL43 million.

Now turning to Slide number 7. We have our quality indicators for Cemig Distribution, DECI, FECi, which have been improving year-after-year, specifically in the last few years we are lower than the regulatory limit and we have higher margin between the realized and regulatory limited. In September of 2020, the accumulated DEC for the last 12 months was 9.32 hours vis-?-vis 10.44 for the regulatory limit. And that shows that in 2020, probably, we are going to be lower than 10 hours. That is the first time that our DCR average audit duration per customers in hours is lower. Our FEC has always been very comfortable, but we are still working to improve it anyway. And in September of 2020 in the last 12 months, the indicator was at 4.63%.

Turning to Slide number 8, Cemig Distribution. We have here the load for Cemig Distribution and the load does not necessarily translate into build the market in the financial figures, but that is an indicator of what is to come in terms of revenue. And here, we can clearly show the significant recovery that Cemig Distribution market ahead after the pandemic and we can see that in April, when we compared to April of last year, we had a drop in the load of over 10% and in September, we already had an increase vis-a-vis September of last year of 3%, and October, even more. So this is a strong recovery specifically because of the recovery of free clients in the concession area for Cemig Distribution.

Now turning to the next Slide number 9. We have here once again Cemig GT load and that's what we are comparing here with the consumption over the year because of the seasonalization and also changes in the market year-on-year. The comparison sometimes is compromised, but we can also see this recovery coming in very strong, similar to what we see to the total distributed energy for Cemig Distribution and here, the consumption and the load that we have Cemig GT in April, you see the recovery of October, it's over 22% is 375 average megawatts. So this is a strong recovery and we see that most of that recovery is thanks to our incentive-bearing client that has increased to 28%, but the free conventional client also has operated significantly and it has grown at 19% in the quarter.

Now turning to the analysis of the results of the third quarter themselves. Here on Page 11, we have the main effects on the results of this quarter and we should highlight them to better understand the results that will then bring to you. For Cemig Holding and the consolidated results, we had the restatement at market value of Light. Remember that Light is an asset that is available for sale in our books.

FINAL

So every quarter, we have to mark-to-market the value for Light and the reference of the stock price in the stock exchange market -- so on the stock market, sorry. So the stock price in September was BRL14.50 and we had to bring down the amount posted for that light is posted for in our balance sheet and so the net income would be BRL90 million and there was a reduction of BRL136 million in our balance sheet. But in September, the share -- the stock price was at BRL22.75 and if that is still -- that holds, we will have a positive impact in the fourth quarter.

About Cemig Distribution, we had a growth market. The total energy distributed is growing vis-a-vis last year. It has increased 1.4%. The captive market had a drop vis-a-vis the third quarter of '19 of 3.6%, but transmission or transport for free clients in the concession area grew 7.8%.

And as I said before, we had a reversal for ADA of BRL231 million, but in the last 12 months, it was a reversal of BRL178 million. About Cemig GT, we had a quarter that was much better. It was very good, but operation wise that was very good. But in terms of our finance, we had the mark-to-market of euro bonds and the hedge instruments. In a way that we had a negative effect of BRL244 million in our financial results compared to negative effect that was very low in the third quarter of '19, which was of only BRL12 million.

Now turning to Page 12 of the presentation. We have here the impact itself of the euro bond. This is the breakdown. And in our opinion, this was a temporary effect because of the FX hedge -- I'm sorry, FX pressure and the volatility, both in the domestic as well as international scenario. Here we see on the chart that our hedge instruments have not varied in this third quarter and because of the reals depreciation, the bond had an increase of BRL247 million. And at the end, we had a financial -- negative financial effect of BRL244 million.

Turning to Slide 13. We have here our EBITDA and net profit for the nine months. Our CEO mentioned, the adjusted EBITDA had a growth of 2.7% in the nine months of the year, reaching BRL3.688 billion in the last nine months and the net profit had a growth, even more significant of 12% reaching over BRL1.7 billion. On this chart -- on the bottom chart -- on the bottom part of the slide, we have the adjustments made in 2019. Maybe the most relevant ones were the Pasep and Cofins in the second quarter of last year over ICMS. And also, we had the provision for receivables at Renova BRL688 million.

We also, last year had the provision, we have to remember that of that profit sharing program that we held. And this year also, we had a Light restatement, a positive effect of the tariff review of the transmission company and the reversal of the provision I mentioned before. So just to have that -- bear that in mind when you consider the recurring results of our company.

Now turning to Slide 14. We have the breakdown for distribution market or GT market, we had a growth of 1.4%. And as I said, the captive market was down 3.6%, and transport and transmission for free clients increased 7.8%. If we break that down by the type of consumers, we should highlight our residential customers, then that is still growing 3.7%

FINAL

year-on-year. Industrial also grew 5.6% and in the quarter still our commercial clients had a reduction of 16.8% because the stores were basically closed also in the third quarter.

On the next Slide 15, we have our adjusted EBITDA, adjusted net profit consolidated just for the third quarter of 2020, which improved, adjusted EBITDA grew over 24%, reaching BRL1.329 billion a level that is very sound for recurring EBITDA, as we already mentioned and adjusted net profit also, we had a growth of 7% strong growth and with a quarterly net profit of BRL644 million, a very strong result. On the bottom, we see the adjustment chart, I already mentioned.

On Slide 16, we have adjusted EBITDA and profit for Cemig GT, which also have increased. It was up 61% on top of the third quarter of '19 with adjusted EBITDA of BRL539 million and adjusted net profit, also we had a strong growth of over 200% for Cemig GT, reaching BRL164 million.

On Slide 17, we have adjusted EBITDA and adjusted net profit for Cemig Distribution. Cemig Distribution had a slight reduction of 7.6% in the adjusted EBITDA, reaching BRL572 million and adjusted net profit was up 22.4%, reaching BRL306 million.

Now turning to Slide 18. In terms of cost and operating expenses, we also had a very positive performance, but I'm going to ask to our CFO and IR Officer, Leonardo George de Magalhaes to talk about it.

Leonardo George de Magalhaes {BIO 21639277 <GO>}

Good afternoon, everyone. Thank you very much for participating in another video conference of Cemig, where we have the opportunity to explain our results. As Dr.Reynaldo mentioned, these were sound and good results that show the resilience of the company during the pandemic. And Velez has already commented on the main results in the quarter and here, we are going to concentrate on operating costs and expenses. We see that the company is maintaining the efforts to have operating efficiency. We were able to reduce our manageable costs, our PMSO costs, basically for materials, outsourced services and headcount and 4.7% vis-a-vis the prior year without any inflation adjustment here.

So if we adjust it by the inflation, we are able to see the company's efficiency of almost 7% in cost reduction when compared to the prior year and we think that these are relevant results of the company and we continue working to bring down costs. Therefore, it's important to highlight that there was an increase in the profit sharing program in the quarter, to be specific, but in the year-to-date, there was a reduction from BRL160 million to BRL190 million just in the accumulated in the quarter, and also another highlight here, it has to do with the provisions for ADAS and we are able to sign an agreement with the state.

And therefore, we ensure that overdue payments from the state will be paid by the settlements and we are going to offset those and discount from the ICMS credits. And also last year, we remember that there was a large provision over BRL1 billion based on

our also profit sharing program. And these were tax contingency provisions and that affected our results.

Now on the next slide, we have our OpEx, our realized OpEx and the OpEx with regulatory targets. This was a landmark for us because all our OpEx was covered by our tariffs. This is the first time this happens and this is the company's commitment. We committed ourselves on the Cemig D that by the end of the year, we would be able to have our OpEx within the regulatory limits and we anticipated the process. So in this third quarter, we already bring to you this good news. We are BRL127 million lower than the regulatory target. Even if we consider the costs that we knew that would be difficult to cover for with the tariff, such as post retirement. But even then, the company was allowed or we were able to have that still for 2020.

About the EBITDA, we are lower than the regulatory targets, BRL73 million, and here we have on the company's additional and relevant effort related to non-technical losses that caused us to have losses in almost BRL200 million up to the third quarter. The company is taking several actions. These actions are already being implemented. So that by the end of 2021, we are able to reduce these non-technical losses to close to zero. So once again, we are able to reach our coverage of 100% of what the regulation guarantees. Remember that there is a small chart here on the bottom. In 2018, we only had 78% of our OpEx covered by our tariffs in 2018, and in 2020, there's -- because of our efforts in the past two years, specifically efforts in 2020, we were able to reach the regulatory coverage. So we believe this is an important effort, an important landmark for Cemig Distribution.

On the next Slide number 20, we have our consolidated debt profile. We see here our indebtedness profile. This is a dock for the next years that can be managed with the cash generation that we have plus the cash of the company that we have so far, we're able to go through '20 -- can go in 2021 with no extra fundings. We have in 2024 our bonds due BRL9 billion, but also, it's important to let you know that we have a hedge for the interest rates and up to BRL5, so this bond is hedged. Therefore, this debt of BRL9 billion would be at a lower amount. And the important management message is that we are paying attention to this topic.

We understand that in the first quarter of next year under a more stable scenario and we expect it to be a scenario with vaccines and the market will have less uncertainties and the interest rates will be at a normal rate or with less uncertainties and with a better risk level and the company will restart a process to -- of liability management for these bonds. So we are at a very comfortable position and that translates into the company's leverage, which today is at 1.55 of our total net debt over EBITDA, very comfortable and that also has affected our ratings, as well as mentioned.

The ratings are continuously improving and we understand this is the trend for the future. And we expect to continue on that improvement scenario, improvement of our liquidity as well as reduction of our indebtedness.

FINAL

On the next Slide number 21, we have our liquidity, our cash flow generation that is amazing for the quarter. In the nine first months of the year, we were able to generate around BRL4 billion in cash. This is significant in addition to other factors that have helped us to maintain the liquidity level and the cash close to BRL5 billion by the end of the third quarter of 2020. We understand that this is very important and that balance allows the company to tackle the challenges still in this year-end with no vaccine on the market. Still suffering because of the economic deceleration, but that will ensure the company is comfortable situation for the next few months.

On our next slide, before we turn to our Q&A session. These are the company's expectations, which are very positive, starting by solutions for GSF. Regulations are still ongoing with the regulating agency and we have a favorable expectation to extend for two or three years our planned concessions, not only Cemig's plants, but also our investees, Alianca and other ones where we have taken a stake and thanks to this major GSF agreement, we probably will have the extension of these concessions translating into more value to our company.

We have an important digital transformation project. We plan to change our relationship to turn it to a more modern approach, updating our platforms, the virtual assistance and also having robotic processes to change the level of our relationship with our customers. In terms of our new investments, specifically in generation and wind projects and also photovoltaic plants, we have a portfolio to be analyzed of over 2 gigawatts and also for solar plants, we have also a portfolio close to 2 gigawatts. Both are profitable projects that will generate value for the company and in a very safe, conservative fashion, always thinking in terms of adding value in a responsible fashion, the company will analyze these projects in the short and in the medium and long term.

So this is also we have a revision process for our strategic planning in order to analyze opportunities and challenges for Cemig's considering renewable energies and in an environment of the electric sector in Brazil and in the world for the next years and how the company has to prepare itself for this competitive environment. There is a project called new energies. And the aim here is to boost our organizational culture.

This is a company with over 60 years of age, it has a lot of strength that needs to be valued, but also we need to improve our processes and behaviors that can contribute to a culture that is directed to results and we believe this is important. And it has everything to do with this administration's target to turn this company into a more efficient one.

And finally, divestments. We maintain the commitment to rightly allocate our capital and the company is still interested in maintaining its remaining stake in Light. This is one of our priorities when we talk about our divestment portfolio. These were the slides that we had to bring to you. These are very good results, showing resilience in the company and we are very optimistic about the future and all the projects that are being developed in the company in order to develop value to our shareholders.

Questions And Answers

Operator

(Question And Answer)

We will now start the Q&A session. (Operator Instructions) There is a question from Rosalina. The question is when are you going to be paying dividends and what about the dividends policy?

A - Unidentified Speaker

Thank you very much for your question. The company in the last meeting with investors, the company stated that our purpose right now is to maintain our policy of 50% of dividends payment. We believe this is balanced and this allows our shareholders to have the right remuneration and also it allows the company to have the liquidity position, which is important right now considering that in the midterm, we will have the maturity of plants, Nova Ponte and Emborcação, and we are going to have a grant payment to maintain those concessions. And also we have a large investment program in the distributing company.

So right now we believe that this policy is adequate, but of course, we are always reviewing and trying to create value to shareholders. And if we have a better liquidity situation and if we have a comfortable leverage situation, we might think about paying additional dividends. But right now, we want to maintain our policy of 50% dividends payment.

Operator

(Operator Instructions). There are no further questions. We turn the floor back to the management for their final remarks.

A - Unidentified Speaker

Very well. Ladies and gentlemen, thank you very much for this teleconference and video conference actually. Teleconference is something from the past already. Really, these are consistent and sound results, showing that the path that we have chosen is the right one, and we do have favorable perspectives. And I should highlight the two last subjects that Leonardo mentioned. It's important that we are working on our strategic planning. We wanted to have a future view for Cemig, a future scenario, and along with planning always associated to an organizational culture, understanding a rationale of results of decision -- private decision making process, which will help us and will prepare the company for future challenges. Thank you very much and have a nice afternoon.

Operator

Cemig's conference call has ended. Thank you very much for your participation and have a good afternoon.

FINAL

Bloomberg Transcript

FINAL

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript