

Q3 2016 Earnings Call

Company Participants

- Henrique Manuel Marques Faria Lima Freire, Chief Financial Officer
- Miguel Nuno Simoes Nunes Ferreira Setas, Chief Executive Officer and Investor Relations Officer

Other Participants

- Unidentified Participant

Presentation

Operator

Good morning and welcome to the conference call of EDP Energias do Brasil to discuss the earnings of the Third Quarter 2016. Right now, all participants are in listen-only mode. Later on we are going to start the Q&A session when further instructions will be provided. (Operator Instructions) This presentation, together with the slides, will be simultaneous webcast on the Company's website www.edp.com.br/ri. In there, you will also be able to obtain the Company's earnings release.

Before going on, EDP Energias do Brasil would like to let you know that any statements made during this conference call relative to the Company's business outlook as well as its projections, operating and financial goals with regard to its potential growth are based on assumptions based on the management's expectations with regard to the future of EDP Energias do Brasil. Forward- looking statements will depend on the country's economic scenario, the performance and regulation of the electric sector in addition to other variables, and therefore are subject to changes.

Now, we'll turn the call to Mr. Miguel Setas, CEO and Investor Relations Officer of EDP Energias do Brasil to start the call. Please, Mr. Setas, you may go on.

Miguel Nuno Simoes Nunes Ferreira Setas {BIO 15901389 <GO>}

Good afternoon, everyone. First of all, I would like to thank you for joining us in this call of EDP to discuss the earnings of the third quarter 2016. Today with me is Henrique Freire, our CFO, and some executives of EDP Energias do Brasil.

I would like to start our call highlighting two very important event in the last quarter. The first that took place last Friday, which was our participation in the transmission auction competing with two lots, 21 and 24. As you know, we have a distributor company in Espirito Santo, Escelsa, and therefore the choice of this lot was basically based on the

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region in which we are familiar with administrative and lighting processes that should be needed to implement the project. And therefore, we are very much aware that our participation was still a bit limited in this auction. And I would like to leave you with two messages about our participation. First is that we opened the new tranche of growth in a segment in which we did not operate before strategically. As you know, in the past we sold the transmission line in the State of Espirito Santo and therefore this is a reopening of a new tranche of growth for EDP Brasil in a segment in which we were not operating in.

The second message is that we did not jeopardize our profitability. We lost lot 24 because the value of the discount was below the minimum amount that we consider for profitability. So I think that it's important to show that our decision was based on capital discipline that we have been engaging in for sometime now in the best part of our strategy.

We will now go to page 4 of our presentation to talk about the main highlights of the tariff review of Escelsa. I think it's one of the most important events with regard to the value creation that took place last quarter. The slide summarizes, in a nutshell, the results of the tariff review. We had in evolution of component B of about 10% when we compare the review of our peer companies and even our distribution companies. We believe that it is substantial increase, a quite importance increase of component B.

In addition to that, we also had an increase of our net and gross remuneration base, net more than 2 billion and gross more than BRL3.5 billion. So, again, this increase reflects the regulatory EBITDA of Escelsa as of this tariff review. To your right, we have mentioned two technical losses. You see the technical losses went from 6.70% to 7.14% and non-technical losses in low voltage in turn went from 7.87% to 11.45%. And again, here it's important to highlight that they now have a flat trajectory, that is without much change during the tariff review. All that considered, to the left of our bottom part of our slide, we see that the regulatory EBITDA trend represents an increase of 35.5%. We just did simple math here and we see that the impact of this tariff review is an increase in component B of BRL62 million and an increase of allowed losses of BRL40 million. This incremental EBITDA of BRL102 million could be estimated at about BRL1 per share in the value of our shares. Today, we have 600 million in shares under circulation. And therefore, I would like to highlight, perhaps this as well as the main event for the creation of value in the third quarter 2016.

Now, we are going to page 5 of our presentation and I'm going to briefly give you the main highlights in addition to our participation in the transmission auction and the tariff review of Escelsa that I mentioned in the introduction of this call. Well, in generation, I would like to remind you that on August 5, we started the start-up of the last unit of Cachoeira Caldeirao completing the project and therefore anticipating our start of operation and sales as of now are being either to the free market or by means of bilateral contract.

So this is another moment in which together with the performance that we had enjoyed, we were able to reinforce the delivery of projects within time and budget, which is something that we have been pursuing in recent years as a core part of our strategy.

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As for Sao Manual, we had an evolution of 78%, clearly, again, within the schedule estimated in between the earlier and latest curve and average paying [ph] signalizes for this project should be delivered within the time expected and regulatory times as well. So, with regards to plants that are under construction, I think that we have good news in this quarter with Cachoeira Calderiao is reinforcing the rational that we are following in generation. As for thermal energy, by means of our Pecem centers, I'd like to highlight that we closed the quarter with an average availability of 81.6%. Year-to-date, that accounts to 87%. This lower amount in the third quarter basically has to do with programmed maintenance for our machine number 2, generating new unit number 2, and we should close the end of the year close to 90%, which is our regulatory objective.

Still about this thing, I would like to talk about two points, one is the water situation in Ceara. As you know, Fortaleza today is experiencing one of the worst droughts in the past 66 years. So, we got a severe drought and that obviously may have reflexes on the water supply of the same plant. The solution has been to work with the Government of Ceara and the Ministry of Mines and Energy, and perhaps have the collection of what we call an emergency hydro charge.

That was in aid of the state government to fund a set of constructions complementary to the constructions that are ongoing in the state to enable us to withdraw additional water from the Castanhao reservoir. So, this hydro-charge type of (inaudible) coupled by the state government of Ceara, and we ask ANEEL, the regulatory agency, for this charge to be fully passed on the bearable unit cost of the plant, therefore, making it neutral 4%. We are still waiting for ANEEL's decision to our request.

Additionally, I would like to mention and you'd probably notice that the operating costs of the plant have suffered additional costs because of coal logistics and I would like to tell you that happened because of the transportation of coal and the prices this year with (inaudible). You know that we share road logistics of coal with them. And so, we have complementary costs for the road transportation of coal to the plant as a complement to the sea transportation. This coal is unloaded in the ports of Pecem and then taken to the plant, which generates an additional cost that affects the margin of the plant. So, Pecem has a stabilized operation and it's availability in our view is close to the regulatory landmarks and the points of attention are the water situation and cost with coal transportation.

As for distribution, I would like to mention that September was the first month in the quarter and in the year, as a matter of fact, that we have in Escelsa a volume that was above last year. In Bandeirante, that is the fourth month in a row that we have volumes above last year. So, again, in our point of view, we already got to the bottom and our prospect is that our volumes will pick up until the end of the year and will show evolution in 2017.

In this quarter, we have a variation, income variances up 1.2% compared to last year and minus 13% in Escelsa compared to the same period last year. So, in Escelsa, as you know, we had volumes that were very much affected by the downtime due to the operations of Samarco in (inaudible).

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Other two positive aspects of distribution, the first with regard to losses, is specifically non-technical losses in low voltage, but the distributors had positive evolution, minus 0.97 percentage points in the Bandeirante and minus 0.90 percentage points in Escelsa compared to the third quarter '15. And in Bandeirante particularly, a loss of 9.61%. It was the first time that we were below the regulatory losses of 9.83%.

So, we see that in Bandeirante we're already below the regulatory losses and we hope the curve to continue in the same direction in itself, minus 3 percentage points compared to the regulatory losses; it's now 11.45. So, we feel very positive evolution for both distribution companies, also PDD and delinquency, it was the first quarter of the year in which we had a reduction of PDD compared to 2015, minus BRL2.6 million compared to the third quarter '15 and less BRL19 million compared to the second quarter '16. This is a result of our programs to fight delinquency, increasing the number of cut-off and introducing the renegotiation [ph] of debit with clients and pay debts, of course. And therefore, in our point of view, is together with losses a clear positive trend for distribution.

And finally, a non-recurrent event that took place during the tariff review of Escelsa that, that was a new value for replacement in EDP Escelsa of 146 million. It is again non-recurrent, it's not going to be represented in the coming quarters, but it has a very clear positive effect for the third quarter '16.

Commercialization and costs; in commercialization we had an increase in the volume of energy traded, 19%, and a reduction on the average purchase and tariff sale price of 22%, 20%, respectively. And again, a positive evolution with regard to volume, and again, resuming a more normalized margins than those that we have seen in previous quarters. Also an increase with services revenues with an increase of BRL3.3 million, reaching about BRL15 million, clearly above what we had last year.

And finally, before turning the call to Henrique Freire, I would like to say that we continue to evolve with our cost, below inflation rate. We had an increase in the quarter of 5.6%. This is the result of the programs that we have been calling zero base budget. We have a hundred methods to reduce cost and in 2016 we are already benefiting from these measures and we believe this will continue for the coming year 2017, particularly reflecting the efforts that we have in this program.

And finally, about indebtedness, as you know, we had an increase in capital of BRL1.5 billion, and therefore, we have a very conservative leverage with a net debt-EBITDA ratio of 1.3 times, which shows a balanced distribution that's quite comfortable, quite conservative with much room for us to have an increase in that business in the coming years. With that, I close my highlights and I will turn the call to our CFO, Henrique.

Henrique Manuel Marques Faria Lima Freire {BIO 19117781 <GO>}

Well, good afternoon everyone. We are going to slide number 6 where I show the situation of our debt. So, you know, in the end of the third quarter we had gross debt of BRL5.9 million, with a reduction of about 300 million compared to the end of last -- the

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end of last semester. We had an insurance of 250 million in the Holding. That covers some -- to the majority of the 267 million of the second issuance of debentures. We had also another issuance of 90 million and then we had the capital increase and advanced disbursement of a debt of 3.3 million of CEJA-Holding [ph].

The highlights are Sao Manual, we closed a long-term financing with BNDES in the total amount of BRL1.3 billion with a price of TJLP plus 2.88% in the period of 20 years. We had in September the amount of 852 million and last Wednesday another BRL160 million of these amounts. Also in Sao Manual we had the issuance of debentures with maturity until December 2018 that would be a bridge, and so the issuance of infrastructure debentures. Good numbers that in Sao Manual, we have this debentures in our structure and I think that further debentures will help us in the final completion of the trend. The issuance was at CDI plus 4.35% and because of our cash availability, we bought one-third of the share.

Remember that we have CTG and Furnas as our partners in this project. Our back -- our net debt-EBITDA ratio is at 1.3 times in our consolidated numbers. If we bring to our (inaudible) Jari, Cachoeira and Sao Manual, it's still not completed, we would have net debt-EBITDA ratio of 1.7%. It's important to say that the average cost of debt in the end of the quarter was 13.7% and the average time 3.3 times, very much in line with the position we had in the past. It's important to remind you that the objective of us increasing capital was via [ph] the advanced payment of the IGP funding in Pecem. And this process is moving on. We are in advance negotiations with IGP and the BNDES, and therefore we will probably have this update in this current quarter. Remember that we'll have the reinvestment of BRL1 billion and a new issuance of local debt in Pecem of about 500 million, which is already been agreed on.

Now, we are going to analyze our results on slide 7. And you see the evolution of our results. We reached an EBITDA this quarter of BRL626 million, an increase of about 7% compared to the third quarter '15 and there are some points that are worth mentioning. First, gross margin, as you can see in this chart, having a decrease of 97 million. I would like to highlight some events that will explain the variation.

First, we have the exchange variation, Itaipu which is essentially registration in this (inaudible) measuring the accounting registration and the financial settlement, and then we have an offset in the financial result. And here we had the variation between '15, '16 and it affected negatively our comparison in 43 million, which is quite a significant amount. Also, we had the over-contracting of Bandeirante. As you know, we still have a situation of over-contracting. Probably in the end of the year, the situation can be reversed, but with the information that we have today, we do benefit (inaudible) of nine additional million.

We have accumulated BRL30 million of provisions because of this over-contracting. It's still in Pecem. We have three events that has an impact in the EBITDA [ph] margin. First, on availability; the third quarter '15 had a reversal of this provision when we had the change in the calculated assumption and when we compare the third quarter '15 to the third quarter '16, there is a difference of 58 million, quite significant amount, and as Miguel mentioned, we also had the hiked charges that amounted to 80 million in terms of increase in other account and the transportation of coal because of a different agreement in

transportation, that gave us an addition of BRL23 million in road transportation. Altogether, it has an impact, as you can see.

As for PMTO, as Miguel mentioned, we also have our plan with more than 100 initiatives. We are controlling our cost. They are at a level below inflation. In 2017, we want to continue that. Comparing this quarter to the same quarter last year, we had an increase of only 5.6%. Most companies have more than 9% especially because of collective bargaining and I would like to talk about our PBV. For the first time we saw it go down compared to last year. This quarter we got to 17.6; remembered that last quarter we had 33.7. So we had a reduction of 20 million, so that was a variable that was of quite large concern in the beginning of the year. We said that it was under control and we believe that this is going to be the way for the future.

As for net income, we had the amount of 146 million of the financial results of Escelsa that contributed to our results. As for net income, we reached BRL231 million this quarter. That's just a theory, favorable results comparing to the numbers of last year, most -- because of our financial results. In the number increase, we have a decrease of our net debt, but we are more efficient in our financial investments as well having better performance and therefore contributing for us to show better results.

And in terms of taxes, we had also some increase, although not as substantial, and we closed the amount at 231 million and I'm now closing the conference call and we're going to open for your questions.

Questions And Answers

Operator

Ladies and gentlemen, we will now start the Q&A session. (Operator Instructions) Any questions in English will be answered by the Company in Portuguese and simultaneously translated by the translator. The first question comes from (inaudible).

Q - Unidentified Participant

Good afternoon, everyone. EDP was part of the transmission auction. You participated in two lots, you got one. Strategically, what would be the next steps of the Company for growth? Where do you see more opportunities, what you think of M&A.? Are you thinking of other auctions for 2017? I'd like you to give us more color with regards to your strategy.

A - Miguel Nuno Simoes Nunes Ferreira Setas {BIO 15901389 <GO>}

Hi, (inaudible), thanks for your question. We are going to maintain our strategy. This participation in the transmission auction opens room for a new line of growth and we are going to be analyzing opportunities for organic and inorganic growth in this segment. Until now, it was a segment in which we did not have any strategic focus and now we are going to look into future auctions and any opportunities that may pose to us for non-organic growth.

Our focus for growth for next year are in generation and on distribution as well. We have been saying that we are actively prevailing opportunities in the market. We do not have anything to tell you right now that is more concrete, but we are always looking into opportunities, both in distribution and generation.

Obviously, in generation, the coming year will probably be a year with lower demand for capacity and therefore the opportunities of generation will be more for inorganic growth. We believe that we will have less chances of growth in terms of organic growth, at least in generation.

Q - Unidentified Participant

Okay, thank you very much.

Operator

(Operator Instructions) Our next question comes from (inaudible) from Santander.

Q - Unidentified Participant

Good afternoon. I'd like to ask a question about your Emergency Hydro Charge. I heard that it should be decided by ANEEL today, but it was removed from the meeting's agenda. I would like you to comment on that. And second about your technical losses. I would like to understand how you -- when you think the [00:30:07] (inaudible) technical losses are going to go back to historical levels? Thank you.

A - Miguel Nuno Simoes Nunes Ferreira Setas {BIO 15901389 <GO>}

Andre [ph], thanks for your question. Good afternoon. Well, with regards to the Emergency Hydro Charge, this is a process that is being developed together with the Ministry of Mines and Energy and the Government of Ceara, and now having the involvement of the regulatory agencies.

So, right now we are just waiting for ANEEL's decision. We do not have a final word from them. So, we hope that in the coming weeks they are going to come up with a decision and our expectations, as I mentioned, is that we are going to be able to pass on prices by means of the cost of units.

And as for technical losses in itself, the reduction is going to depend on the amount of water generation. When we have more water generation, we have a reduction of technical losses. Today, they are worsening by the energy flows that we need in the state and that depends on the current water situation. So, we don't know exactly when this is going to happen, but we are hoping that this is going to be strong [ph].

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions) If there are no further questions, we are now closing the conference call of EDP Energias do Brasil to discuss the earnings of the third quarter 2016. Questions taken on the webcast will be later answered by the IR team. We thank you very much for joining us and wish you a good afternoon. Thank you.

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