

Q1 2014 Earnings Call

Company Participants

- Miguel Amaro, CFO
- Miguel Setas, CEO
- Unidentified Speaker, Interpreter

Other Participants

- Carlos Remika, Analyst
- Juliano James, Analyst
- Pedro Masigina, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

(Via interpreter) Good afternoon. Welcome to the conference call of EDP Energias do Brasil in which we are going to discuss the earnings of the First Quarter of 2014. (Operator Instructions)

This presentation, as well as its slides, is going to be simultaneously webcast on the web at www.edpbr.com.br/ri. And there, you can also have the Company's earnings release.

Before moving 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 operating financial goals and projections relative to its potential growth, are based on assumptions based on the management's expectations about the future of EDP Energias do Brasil.

Forward-looking statements depend on the country's macroeconomic scenario, performance of the Company. And regulation of the electric industry, in addition to other variables. And therefore are subject to changes.

I'll now turn over the call over to Mr. Miguel (Amaro), president of the Company. And then we are going to have the (CFO) of Finance and Investors Relations of EDP Energias do Brasil. Please, Miguel Setas, you can start.

Miguel Setas

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(Via interpreter) Good afternoon, everyone. I'd like to thank your attendance in this earnings release for the First Quarter 2014. Miguel Amaro, our CFO, is here. Then we are going to have a summarized presentation of the First Quarter for EDP Energias do Brasil.

We are going to start with slide number 3, starting the presentation. Now the first thing I would like to say is that the First Quarter was marked by an unfavorable hydrologic system. And high thermal dispatch. Those increased spot prices that was maintained at BRL822 during most of the quarter.

In this context, net revenues of the Company grew 14%, through the contribution of all business units. Here I would like to highlight on one hand an increase of 30% in commercialization and 8.3% in distribution.

Our gross margin had a contraction of 9%, a reduction of 9%, because non-manageable expenses because of the energy situation I described in the beginning had an increase of 27%.

As for distribution companies that sell from Bandairante, this impact is partially offset by the resources that the government made available to minimize the impact of tariff deficits in the First Quarter 2014. Those amounted to approximately BRL414 million.

I would also like to highlight manageable costs. These costs went down approximately 2% if we compare the First Quarter of 2014 with the First Quarter of 2013. And this 2% drop incorporates a drop of 3.8%, in distribution expenses or costs.

Also I would like to highlight that personnel, materials and third-party services all had an increase below inflation. And basically this is a response to one of our first priorities, which is really to strict control all our costs. However, the favorable evolution of costs was not enough to offset a decrease of margin that I already mentioned. And therefore, we did have a drop of 12% in EBITDA compared to the First Quarter 2013.

As for net income, we reached approximately BRL100 million, an increase of 10%, BRL9.3 million compared to the same period last years. And this increase encompasses the effect of a lower financial result. And also a drop in the share of minority shareholders and a lower income tax and social contribution in the period.

Additionally, net income was impacted by a better result of Pecem Thermal Company, which loss reduced to BRL48 million if we compare 2014 to 2013.

As for net debt to EBITDA, it had the 5% increase, comparing the First Quarter 2014 to the First Quarter 2013. The net debt to EBITDA ratio closed at a stable 1.5 times on March 31st, 2014.

Finally, I would like to highlight two events that took place since the beginning of the year. First, as we already mentioned in the previous call of the results of 2013, was the

anticipated granting of the federal court to suspend the (calculation) of the unavailability of Pecem. With that, we can hold to the costs for unavailability.

And the second event that was also marking the beginning of the year was the anticipated signature of the concession contract of Sao Manoel Hydrologic plant, which was advanced in 134 days. So this advance enabled us to advance the whole project and also some of the initial steps that were depending on this signature.

So the First Quarter was positive. But was undoubtedly marked by the negative hydrologic system that did have an impact in our financial statements. Well with the first comments, I am going to turn it over to Miguel Amaro that is going to continue the presentation from here on.

Miguel Amaro {BIO 19148334 <GO>}

(Via interpreter) Well. Good afternoon, everyone. We are going to slide four with EBITDA evolution. And profit in the First Quarter 2014. EBITDA in the First Quarter reached BRL406 million, with a drop of 5.7percentage points.

Net operating revenues totaled BRL2.1 billion, reflecting an increase of 8.3% in distribution, 1.4% in generation and 30.3% in commercialization. Non-manageable costs reached BRL1.5 million, neutralized partially by the increases we first mentioned before.

OpEx reached BRL229 million, 2% below the same period, reflecting basically a drop of 38% in provisions. Consequently, EBITDA reached BRL406 million, 12% below the same period of the previous year, with a margin of 19.3%.

So with a negative contribution of gross margin. And positive evolution of costs also because of lower loss in the difference of income tax and share of minority shareholders, we had net income of BRL100 million, 10.3% above the previous year.

On slide five we show the Company's indebtedness. From March 2014 gross debt totaled BRL3.2 billion, a drop of 0.9% in comparison to December 2013.

Net debt to EBITDA ratio was constant, 1.5 times. And to the moment the Company's raised BRL854 (million) and wrote BRL600 million, BRL300 million referring to the holding and BRL300 million referring to Bandairante. The average time of the debt was 2.59 years. Considering Pecem, Cashoeira Caldeiro and (inaudible), net debt to EBITDA ratio would be 2.8 times with an average time of 3.87 years and average cost of debt 8.48% a year.

On slide six we show the evolution of Pecem Thermal Plant in the First Quarter. The average availability rate was 71%, 10percentage points above what was seen in 2013. And remember that Unit 1 was stopped in the month of January because of anticipated maintenance.

On the chart to the right, we show the evolution of EBITDA. As of the Third Quarter of 2013, it's positive, with the commercial operation of Unit 2 and suspension of obligation to buy energy to recompose the Company. We have then our evolution. Remember that additionally, in the First Quarter 2014, the penalty for unavailability was calculated, taking into consideration 60 months and BRL20.4 million.

On slide 7, we have Santo Antonio do Jari reaching 92% of evolution as a whole. We still have pending the operation license and completion of installation and commissioning of electro-mechanic generating units. As for the BNDES financing, we have already disbursed BRL583 million. As for Cachoeira Caldeiro, we started the work in August last year. We already invested BRL229 million and this amount was allocated for the manufacturing of electro-mechanic equipment, designers and the (inaudible). In 2014, we are going to invest 40% of total CapEx in First Quarter 2014, BRL63 million.

Going to slide 8, we have the indicators of distribution. Quality indicators in services were inside the standards established by ANEEL, the regulatory agency, improving compared to the last year, both in Escelsa and Bandairante, reflecting the investments in expansion, modernization of networks, integration and automation of operating centers.

(Size) of Bandairante 7.54 hours. And Escelsa 9.79 hours. (Size) both were below regulatory standards, 5.50 times in Bandairante and 6.22 in Escelsa. Total losses had a reduction of 0.2percentage points in Bandairante and 0.06 at Escelsa, compared to the end of 2013. Both distributors disbursed 15.6 million in programs to fight losses, one of our first priorities. Of the total resources directed to this program, BRL9.5 million were to operating investments and BRL6.1 million for manageable expenses.

With this data, I'm going to turn it back to Miguel for his conclusions.

Miguel Setas

(Via interpreter) Thank you very much. I would just like to finish by reassuring our priorities for 2014 that were also announced in the last call. The first obviously has to do with the energy scenario in the country. As we mentioned in the beginning of this call, we are experiencing quite a stressful energy scenario. And with that, the Company is developing financial regulatory and operating contingency plans to try to cope with this situation in the safest way possible. And the most effective way possible.

The second priority is costs and cash. Here I would like to highlight the 2% reduction of manageable costs and others in the First Quarter of 2014, which shows that we are controlling costs better, along our history. And therefore, this is undoubtedly one of the focuses of EDP management for 2014 that is to continue to control costs in all business units.

In addition to that, I would like to mention our focus to fight losses, commercial losses in distribution, optimize the working capital. And ensure to have suitable funding for company activities in the coming months and years.

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The third point is growth. And here our priority is also very clear, where we have already mentioned and we reaffirm that we want to deliver the projects that we have here under construction, on time and on cost. That means that we want Jari, the hydroelectric plant, to be completed until the end of the year, as provided in our schedule -- and the other two projects, Cashoeira Caldeiro and Sao Manoel, also follow an optimized schedule in constructions.

So the point of this list of priorities is, as what Miguel Amaro just mentioned, we have been improving significantly in service indicators of both our distribution Bandairante and Escelsa. And this is our commitment for the next month, to continue optimizing our service quality indicators.

Finally, the last item of our priority list has to do with Pecem Thermal Plant. Our focus here is really to have financial and operational stability in this plant. In the First Quarter we are having good signs. On the one hand, a level of availability that is higher than 70%, we closed the quarter with 71% -- and on the other side, a solution that is temporary but that minimizes the impact of the Company for unavailability costs that we're being charged from us by ANEEL, the regulatory agency.

So those two elements, operation stability and solution still temporary for unavailability costs, are evident in the results of this quarter. So with that, we are going to close the presentation. And we are going to open for the Q&A session.

Questions And Answers

Operator

(Via interpreter) (Operator Instructions) (Pedro Masigina) from Credit Suisse

Q - Pedro Masigina

(Via interpreter) Good afternoon, everyone. I have two questions. First, in terms of operation and losses, you have been focusing on the fight against losses in that last quarters. You mentioned your reduction program. But when do you think we are going to see a more steep drop in terms of non-technical losses for Escelsa in the next quarters and when the reduction program will be more mature and we are going to have a better reduction?

Also, ENEVA is proposal an increasing capital of BRL1.5 billion. And thinking of the sale of the Pecem II, because you are already partners in Pecem I. Do you think there is a possibility for the Company to think of those assets? Have you talked to ENEVA, just for us to have an idea if this possible? Thank you for very much.

A - Miguel Amaro {BIO 19148334 <GO>}

(Via interpreter) This is Miguel Amaro. I'm going to talk about losses and then Setas is going to talk about Pecem. As for losses. And I think you do have a presentation that is on our website about the measures that we are taking, the types of programs that we have

that are slightly different, I would say, in their approach in terms of Escelsa and Bandairante.

We are focusing on reducing losses. We are not reducing as much as we would like. But the type of loss that we have in Espirito Santo takes a bit more time for us to fix. And also, we have an imposition of ANEEL of a level of annual reduction that is a lot more challenging. This does not mean that we do not have a continuous effort on that. But remember that more than 60%, almost 70% is related to illegal connections. So this is a program that has to do with energy efficiency work, regularization of illegal connections. So it really needs different kinds of efforts.

And clients have to be able to afford those differences and we have to take time. We are working with energy efficiency programs, exchange of refrigerators. So it's a lot of community work as well. So in the end of the year, we intend to continue on a descending curve. But in the case of Espirito Santo, it's still far from ANEEL's target, plan-based points that we use -- a financial language, is something that we would like to reach.

A - Miguel Setas

(Via interpreter) As for your second question, with regard to ENEVA, I would like to mention that we have been monitoring the process on a daily basis. We have been talking to the CEO of ENEVA, Fabio Bicudo. And of course this a situation of attention for us.

The assumption of restructure—the solution of restructuring to be announced can have an impact in our activities. So we are talking to them. There is a joint management agenda (between) EBITDA in an effort for the management of the same one. This has been very positive, because we have identified a set of improvements and optimizations that we can use to manage our assets. And therefore, we are very satisfied and confident with the present moment that the ENEVA EDP is going through.

Obviously any share that is to be sold in Pecem II is not part of our strategic partnerships. I, in the end of the call, announced the five to six topics which are our main objectives for 2014 and in the coming months. But as part of the EDP management, we do have the responsibility of analyzing the whole restructuring process to know what's the implications in our activity will be.

So I would say that this is not a strategic priority for the Company right now, to be part of the process. But obviously we do have the obligation of monitoring and analyzing the restructuring, the implications it may have to our activity. And any opportunities that are being offered in this restructuring process. Then if there is anything to comment, we are going to do so at a timely manner.

Q - Pedro Masigina

(Via interpreter) Okay, thank you very much.

Operator

(Via interpreter) (Operator Instructions) (Juliano James) from Itau BBA

Q - Juliano James

(Via interpreter) Good afternoon. I would like to know what's your expectations for GSF for the year. And how that can impact your location strategy. And also I would like you to elaborate a bit more on energy costs, if the subsidy programs are going to be (announced), if you are talking the government for new investments -- I would like to hear you on these two subjects, please.

A - Unidentified Speaker

(Via interpreter) Hi, Juliano. As for the expectations of the GSF, it's 96% until the end of the year.

As for the allocation strategy, we had already disclosed that (I mean) from the market in the operational release what our strategy is like. And this is something that is already known.

Of course we have a very active position in the market. And we want to minimize the impact of the GSF that GSF can have in the generating companies. Remember that we have an adverse hydrological scenario today, with higher costs. But we started with the expectation of GSF that would be lower and we were able to minimize that. However, because prices are higher. And the market is a bit more liquid. So this is a bit more difficult now.

As for investments that were made, well, this is the solution that was worked along the quarter with the government, with the Ministry of Mines and Energy and with the regulatory agency, ANEEL. So all companies worked with them for us to get to the best solution possible.

I believe that this is going to go on. It's a different format. In the past it was direct investments last year. But this year it's by means of investments so I believe now with the auction and with the little (inaudible) need to all distribution companies. And depending on the evolution of hydrology numbers and the need to have cash of distribution companies, this solution will probably continue to cover for all the partial costs, or even fully, by means of direct investments or by means of tax complements.

Q - Juliano James

(Via interpreter) Okay. Thank you very much.

Operator

(inaudible)

Q - Unidentified Participant

(Via interpreter) Good afternoon, everyone. As commented during the presentation, you have a strong cost control-- costs. What do you expect for the year? Do you think you're going to have better results?

A - Miguel Amaro {BIO 19148334 <GO>}

(Via interpreter) This is Miguel Amaro. As for cost, there is a set of initiatives that are being taken at all units and at all business units. The idea again is to keep flat the costs year on year. And therefore, to have a growth with costs below inflation. Sometimes we have non-recurrent costs that have to be considered. They are due to different effects, sometimes accounting movements that will affect our OpEx. But if you think of our costs with personnel, third-party services, there were a set of initiatives that were adopted and that will yield fruit now.

A year and a half ago, for instance, we had the (various structure) to minimize the impact of poor quality of services in some branches. This increases costs with personnel. But we have a better quality of services. So we did have some initiatives in the year. But at the end of 2012 throughout the year of 2013. And certainly we will have some benefits from that.

Also renegotiation of contracts, we are renegotiating contracts in different areas of the Company. We know that inflation continues persistent. You have been following market reports that have been mentioning inflation levels in services more and more resilient. We are going several months with higher inflation rates. Inflation is persistent. And the idea is for us to be below that and possibly flat year on year.

Q - Unidentified Participant

(Via interpreter) Okay. Thank you very much.

Operator

(Via interpreter) (Carlos Remika) from (Covalenz Capital)

Q - Carlos Remika

Good afternoon. And thank you very much for taking my question. I have several ones. First would be on Pecem I. You mentioned that one of the goals is to be on the stability of the plant. So I was wondering -- would it be enough to assume one more month of maintenance to guarantee that? And if so, do you have any dates, any expected one it could happen?

And my second question would be on the allocation strategy. Now in the market we see that (northern power) price is quite low. And I was just wondering, would you be able to benefit from the spread between the prices in the market? Thank you.

A - Unidentified Speaker

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(Via interpreter) Well I'll have to answer in Portuguese. So there it goes. As for your question about our priorities in the operational stability of Pecem, yes, we are going to have a period of maintenance of the second unit. Remember the first unit had program maintenance that was a bit longer in the month of January, advancing the date that was planned for April. And the second unit is forecasted for a longer maintenance in August. So in the month of May, Unit 2 is going to complete a year of operation continuously, with dispatch of 100%. So it will be time for it to have its annual maintenance. And this is programmed for the month of August. So that's basically the answer for your first question.

The second question I wasn't really sure of what you were asking. If you're talking about spreads in terms of opportunities between the real price and (inaudible) prices. But remember that we have 100% of our energy contracted. We do not allocate that according to a seasonalization strategy. We have in our release, our strategy. I can show you the page where we have our energy allocation strategy. And with that, we do not have the room, or too much room, for us to have a variable allocation. That is, we have already defined our allocation in terms of seasonalization.

With that said, we are going to have a more dynamic activity in the trading company to minimize the impact of future problems. But the generating companies are already what their percentage, closed for the year.

Q - Carlos Remika

Thank you for your answer.

Operator

(Via interpreter) (Operator Instructions)

A - Unidentified Speaker

(Via interpreter) If there are no questions, it appears conference call to announce the results of the First Quarter 2014 is now closed. All questions taken on the webcast are going to be answered by our IR team. We thank you very much for your attentions. Have a good afternoon.

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