

Q3 2019 Earnings Call

Company Participants

- Fernando Cezar Maia, Regulatory Affairs and Strategy Director
- Mauricio Perez Botelho, Chief Financial Officer, Investor Relations Director & Member of Executive Board
- Ricardo Botelho, Chief Executive Officer

Other Participants

- Andre Sampaio, Analyst
- Carolina Carneiro, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by and welcome to the Energisa's Conference Call to discuss the Third Quarter of 2019. The audio for this conference is being broadcast simultaneously through the Internet at ir.energisa.com.br where you can also download the PowerPoint pack. We would like to inform you that during the company's presentation, all participants will be on listen-only mode. Then we will begin the question-and-answer 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 the English version will be broadcast by simultaneous translation. 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 the light of new information or future development. And they depend on circumstances that may or may not occur. Any industry conditions and other operational factors may also affect the future results of the company and, of course, may materially differ in the forward-looking statements.

I will now turn the conference over to Mr. Mauricio Botelho who will begin. Sir, you have the floor.

Mauricio Perez Botelho {BIO 2105889 <GO>}

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Thank you very much. Thank you all for attending our conference call for the results for the third quarter. With me here, we have Ricardo Botelho, who is President of the Energisa Group; Jose Chaves de Melo [ph] who is Vice President for Distribution; Fernando Maia, Regulation Director; Claudio Brandao down Finance Corporation Director; and also our IR team, Deborah Gil Nunes and Bruno Alvarenga. I will be showing a sequence of slides and then we'll open for questions-and-answers. I would like to remind you that just as in the previous quarters, the figures in the operational parts of the presentation are included. The information of the companies, which have been recently acquired, Energisa Rondonia and Energisa Acre controlled by (inaudible). For the financing part, we have pro rata values, which do not consider the acquisition of these companies and only attached the negated distributors.

On Slide 3, we have adjusted EBITDA BRL980 million for the quarter, BRL2.8 billion [ph] in the nine months to 2019 and increased by 18% -- 28.2% and 26.5% respectively compared to 2017 [ph]. Concerning net income, it's BRL54 million for the quarter and BRL174 for the nine months of the period and it's worth noting that the Rondonia and Acre Energisa companies have contributed negatively for the quarter and therefore we are down by 65.6% if we do not consider these companies, the pro forma net income totaled BRL245 million, which corresponds to BRL710 million in the nine-month period of the year, a decrease by 5.3% and an increase by 40.6%.

I would also like to highlight other important events that happened after the closing of the quarter. The first one which caught our attention is the extension of the concession of Tocantins -- Energisa Tocantins for 2020. It was increased with the Ministry of Energy and will be signing this agreement in December. Another highlight is that in October, we had a favorable decision for the tariff review for Rondonia and for Acre. And 15 days later, on October 30, we appealed administratively at the regulators agency asking for the regulator to give their opinion and ask to maintain the same condition and this has been postponed to February 21. Therefore we are asking to keep our assets for June of '19 keeping the Acre and also asking for the IRP, which is the annual adjustment to not to be applied until we conclude this.

On Slide 4, we have the development for the power market with our distributors. The sales of electricity have grown by 4.4% whereas in Brazil, there has been a drop by 0.2%. In the first nine months of the year, this growth was 4.2% against 1.1% for Brazil. That is the dynamic of our action within Energisa still presents a positive differential concerning the average for the country.

Growth for the third quarter is due to the performance of the household consumer class which advanced by 8.2% for the quarter and commercial 6.3% in the period. This has been influenced by the high temperature in our regions and also the calendar factor also affected it positively. I would also like to highlight Energisa Mato Grosso with a growth by 8.4% in the quarter. Household also grew by 14% and commercial by 8.6%.

Energisa Mato Grosso do Sul obtained the second best performance, which was 6.8%, also influenced by the households and commercial segments. In the North region, Energisa Rondonia also performed well, growing by a 6.8%. And we had experienced the highest temperature in the last 30 years in the state and this influenced, obviously, the

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increase of the segment for households and commercial. Acre also had a significant development in the quarter of 8.7% in households and -- actually 8.7% on average and households by 9.5% in commercial 15.1%.

Moving on to Slide 5, you can see our efforts to register low-income clients. Between September 2018 and 2019, we increased our client list by 151,000 clients low income segments with a highlight for Energisa Rondonia and Acre. In June of 2019, we also added 90,000 clients to the low income bracket.

On Slide 6, to your left, we have the history of losses. The indicator was 13.6% considering all the companies in the group which account for 0.56 percentage points above the target for the regulator. If we do not consider Energisa Rondonia or Energisa Acre, the total power losses represent 11.6%, which means, 0.15% below the target. The highlight for the quarter is in Energisa Mato Grosso, which reached the best performance of the group when compared to June 2019 and September 2018. It was the first time that this concession reached the regulators target since its acquisition in 2014.

We still have many challenges in this particular company and we are working hard to keep this indicator within the target. Energisa Paraia is temporarily above the regulator targets which is explained by the raise in non-technical losses, which has been dealt with through an additional plan of fighting fast. We have been intensifying our security and choosing actions and this has been implemented in 2018 and has been intensified in 2019. This can be explained by the worst of the social economic indicators in the region. Energisa Acre is below the regulators target whereas Rondonia is 6% above the regulatory limit. We have proposed a wide scope of measures to deal with the situation by increasing team, inspection teams, focusing on choosing and focusing on areas of land invasion.

On Slide 7, we have quality indicators except from Rondonia, all distributors within the Group are below the regulators' limit for quality, which is good. Many of the concessions are continuously improving their own figures. They're beating their record historically. We have for Energisa Paraiba, Energisa Tocantins in the average outage frequency and outage frequency -- average outage duration is also better, not considering Energisa Rondonia, Energisa Acre, Energisa Tocantins presented a better performance of the group with a reduction of 4.3% and the average outage duration and 2.6% in the outage frequency ratio. Energisa occupies the second place in this ranking improving 8.85 hours [ph] and the average outage duration and 2.05 times in the outage frequency ratio. Energisa Rondonia and Energisa Acre continue to be the target of our plans of investment and maintenance after their acquisition at the end of the last year. We are speaking of training teams, automatizing networks and taking measures to clean and tree pruning [ph] in order to improve these two concessions.

Moving on to Slide 8, we have the financial information. In this case, we do not consider the results for Energisa Rondonia and Energisa Acre. We're doing a PMSO pro forma. There was a reduction by 4% in the quarter in the nine months of the year. The amount is in line with the same period of last year. If we do not consider non-recurring events in the third quarter of '18, such as labor compensation in Sergipe and in Mato Grosso do Sul and also the payments of lower fee in Energisa Mato Grosso and PMSO for the third quarter

of 2019 would have grown by 2% compared to this third quarter of 2018. It is still below the inflation of the period.

A significant parts of the adjustment and increase in staff is explained by wage readjustment and increase in the number of employees, especially at the holding company because it has now increased its scope of activities with the shared service center. On the other hand in line with human resources, we've had a drop in labor compensation, especially in Energisa Mato Grosso do Sul and Energisa Sergipe. The reduction in services was impacted basically due to lower costs in consulting and in Mato Grosso do Sul as I said, we are now migrating the systems.

On the following slide, which is Slide 9, we have a brief analysis of PMSO for Energisa Rondonia and Acre for the quarter and for the last nine months. Excluding non-recurring events, which affects obviously, and pollute so to speak, the results. For both companies, these events are non-recurring and basically refer to layoffs such as the incentive retirement program and voluntary layoff programs and as well labor compensations which affects the line of personnel. And in the line of services, these events are related to the consulting that we have hired and for the process of extraordinary tariff review for Legal Consulting.

According to the charts, in the case of Rondonia, there is a BRL110 million in non-recurring expenses in nine months and Energisa BRL23 million of non-recurring events for the same period. On Slide 9, we have a charge for the consolidated EBITDA pro forma. The adjusted EBITDA, not considering Rondonia and Acre, totaled BRL1.02 billion for the third quarter and BRL2.89 billion in the year and increased by 33% and 31% respectively.

I would like to highlight that taking away the non-recurring events that we have detailed in this presentation, EBITDA for the quarter would have grown 24%, influenced by the increase of BRL136 million in Parcel B for the distributors. The same indicator for nine months improved 37%, with an impact of Parcel B of totaling BRL616 million.

Going on to Slide 11, where we have the net income for the quarter, consolidated figures with a reduction of a decrease of 5%. Within the non-recurring events that we mentioned above, I would also like to highlight the subscription bonus attached to the seventh issuance of debentures with an impact of BRL172 million. I would like to highlight that this had no effect for the cash of the company. Excluding these extraordinary events, net income for the third quarter would have been BRL369 million, that is 33% above the third quarter of 2018.

In the year, the net consolidated income, pro forma totaled BRL709 million -- BRL710 million, which is an increase by 41% compared to the nine first months of 2018. Taking away what we mentioned, there is an attachment to this presentation where you can see the amount for the 7th admission [ph] and it's BRL484 million and net income for the first nine months would be BRL1.04 billion, 105% above than the recorded for the same period of 2018.

If we look at company's indebtedness, we have BRL12.9 billion [ph] consolidated debt. In this amount, we include the total of BRL907 million which refers to the bonus of subscription of debentures, which is also included BRL610 million associated to this bonus. Assuming that this bonus is enforced, the effect would be a reduction by BRL1.5 billion in the net debt, which would mean a reduction by 0.3 times in the net debt indicator per [ph] EBITDA. This covenant indicator was stable at 2.8 times.

This highlighting as mentioned in the first quarter, this amount takes into account -- accounting for BRL1.2 billion, resulting from the combination of businesses, referring to the acquisition of Energisa Rondonia and Energisa Acre which was written in the fourth quarter of 2018. Without considering this amount, this indicator would be at 3.7 times which is the level within the renegotiated limit for this year, which are between 4.5 times to 5 times.

The following slide, we have company investments for the quarter totaling BRL870 million, the first nine months totaling BRL2.17 billion and in this transmission segment, we invested approximately BRL118 million in the quarter and BRL237 million for the year.

On the following slide, we have information on transmission to update you on the project and the auctions, Energisa Goias, Energisa Para I. We started in September and October. In Goias, we had a physical advance at 91% and 66% in Para. And this increases the possibility of anticipating the entry to begin operations for the date bringing forward the date of operation.

In terms of land, the negotiation with owners have been affected by the lines and the transmissions listed above, are almost concluded and we hope to close this in 2024. In Energisa Para II which is amounts to be -- bought in the auction in 2018. The works began in June of 2019 and the physical advance of this part is 20%. In Energisa Tocantins Transmissora which was acquired in December 2018, the basic project was submitted in July of 2019 and part of the studies to request for the preliminary license have already been submitted at the environmental regulator, also in July. And we have started negotiating with the landowners affected by the project. Together, these four add to an RAP of approximately BRL189 million with a CapEx estimated at BRL1.6 billion.

This is what I had to say. I would like you to feel free to make any questions you may have.

Questions And Answers

Operator

Yes, yes. We will now continue and open up for questions-and-answers. (Operator Instructions) Any questions? The first question (inaudible). (Operator Instructions) Our first question comes from Carolina Carneiro from Credit Suisse. Carolina, please.

Q - Carolina Carneiro

Good afternoon. Thank you for the call. I have few questions. The first one concerning your cost performance. You have given some detail on slide and on the release some

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points that have affected the quarter, but in the release, you mentioned the reversion of a provision that would or have affected specifically this quarter. Could you please elaborate on this? What specific provision was this and what was the amount? If you have this question -- if you have this information. The second is the RPF reconsideration request in Rondonia and Acre, do you have an update for this? For the first calendar? When should we expect an answer from the regulator concerning the reconsideration request and also what are your expectations concerning this request?

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

In terms of your first question, I would like to remind you that we had in the case of Mato Grosso around -- in 2018 around BRL17.7 million and basically, they are related to tax law suits and therefore the impact in 2018 and 2019. And when we also had an issue with IP [ph] when we completed the migration of the system, last year we had (inaudible) in Mato Grosso and this year, we don't. So we have around BRL200 million impacted the quarter. Okay?

Concerning the expectations of the provision, we did -- we sanitized as we call it, the Acre, Rondonia. And we have a re-analysis that we did for these provisions. So basically if you have a certain level of compensation, for example, let's see equipment. This equipment cost an average this. We compare the practices in this region with another region and we adapt the practices that we sign. So we can't really say there is a specific one single item. There are several items involved. Every kind of provisions. It could be related to civil law suits, labor law suits, tax.

Concerning the tariff review for, I'll give you -- I'll give the floor

A - Fernando Cezar Maia {BIO 20246374 <GO>}

Good afternoon, Carolina. Concerning the reconsideration request, we did file it on time. This request has been forwarded to the -- to (inaudible) who will be giving the right -- the opinion on it. They have had a very busy month, but we have talked to their advisers and the Superintendent on the reconsideration request. And what we have seen at the level of the Superintendent is that they understand our arguments and therefore our expectation is that we have a positive outlook on this.

And to maintain the date of December and due to the need of analysis, a validation of the basis, this process is probably going to be carried out in February, but they would keep the date. And to reinforce that, we have already submitted the LGBT [ph] for Acre and now we are working on Rondonia's. So even this brief that they missed and appeal that they required, we would -- we show that it's not necessary, but we do -- we have already met their request and filed it anyway and therefore this reinforces our positive outlook on the fact. Thank you very much.

We also filed another request they asked for which is the conciliation of the accounting information with the expert opinion on it. This has also been filed. Thank you very much.

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Our next question comes from Andre Sampaio from Banco Santander. Sir, you may proceed.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good afternoon. I also have two questions, one of them concerning the regulator act. Could you comment on how this has been developing? And the second question is on the renewal of the Tocantins concession. Do you have any updates on this?

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

I'll send -- I'll give the floor to Fernando Maia. So he can give you more details.

A - Fernando Cezar Maia {BIO 20246374 <GO>}

I understand that you are asking about the public hearing, right, of the new regulation that will be valid as of January 2020. Is that it? Is that what you want to no? Yes, it's 2020, but in practice, it will only operate in April. The proposal was below what we expected. There is a lot of room for improvement, especially in terms of the differentiation with the distribution business. And the entire group, all the companies, we are organizing everything to take this information to the regulator and we have a positive expectation in terms of reversing this amount. There is an ongoing discussion on the frequency, the regulator's proposition is to have a work [ph], which is shorter.

We had already submitted a possibility of choosing work, especially to enable this better vision of an annual work. We will be reinforcing this proposal -- this request. And therefore, we believe, we think this is likely to be applied and will be therefore giving more stability in terms of remunerating the capital. That's what's the issue, which is still open, the work issue concerning Tocantins.

Yes, please. Concerning extending Tocantins concession, we have already dealt with the Ministry of Energy to draft the agreement and it will be very similar to a previous agreement we have signed when other companies also had their concessions extended. And the Mining and Energy Ministry has issued a legal opinion and a decision which is favorable to this extension. All we have to do now is wait for the execution of the agreement which may occur in December. So, this is something we -- it's already solved.

Q - Andre Sampaio {BIO 19422379 <GO>}

Thank you very much.

Operator

(Operator Instructions) I would like to give the floor back to Mr. Ricardo for his final words. Mr. Mauricio or Ricardo.

A - Ricardo Botelho {BIO 2105867 <GO>}

Good afternoon. Thank you all. Our third quarter conference call was very fruitful. Thank you for your questions. I thank you also for listening to our challenges and our

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achievements. We are fully committed to the quality of our services focusing on the satisfaction of our clients and consumers. Our entire company aims at improving its assets and we are proud to say that in this quarter, 10 out of the 11 distributors have quality, service indicators below the regulator's average, with a particular highlight too, Energisa Tocantins which has had its best historical figures and development within the companies. We also like to highlight that the losses are at a reduced pace and we will be consistently working to improve it.

The important acquisitions for 2018 Acre and Rondonia are now part of Energisa and are using the logo and the trademark and the colors of Energisa. We are completely focused on the turnaround of our distributors and we are sure that all the challenges make us want to work even harder to attain success in this important company. As Mauricio said, we are optimistic in terms of our projects starting to operate because of our pace of building. We are also looking at auctions in December, especially such as which have synergy with our concessions and distribution and offer attractive return in term of value generation for our services. We would like to thank you all again and we wish you a very good afternoon.

Operator

Thank you. This concludes Energisa's conference call for the third quarter of 2019. You may disconnect.

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