

Q4 2018 Earnings Call

Company Participants

- Henrique Manuel Marques Faria Lima Freire, Chief Financial Officer
- Miguel Nuno Simões Nunes Ferreir Setas, Chief Executive Officer & Investor Relations Officer
- Unverified Participant

Other Participants

- Thiago Silva, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and welcome to the conference call of EDP Energias do Brasil to discuss the earnings regarding the year of 2018. Right now, all participants are in listen-only mode. Later on, we're going to open for the Q&A session and further instructions will be provided. This presentation, together with the slides, will be simultaneously webcast on the company's website, www.edp.com.br/ir. In there, you'll also be able to find 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 relative to the company's business outlook as well as projections, operating and financial goals relative to its potential growth are based on - forecasts based on the company'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 in the industry, in addition to other variables and are therefore subject to changes.

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

Miguel Nuno Simões Nunes Ferreir Setas

Well, thank you. Good afternoon, everyone and welcome to our press conference of the fourth quarter 2018 and also the end of the year of 2018. I'm here in this room of our board with our VP, our CFO, Henrique Freire; and other executives of the company that will be available for any questions or doubts you may have.

So we are going to go straight to the presentation of our call, and I'll start with page number three. This fourth quarter and end of year F2018 was to us very meaningful in

such a way that we closed the cycle of investments in Generation. As you know, we had three hydro plants being constructed, Cachoeira Caldeirão, Santo Antônio do Jari, and most recently São Manoel. And in the end of 2018 São Manoel started in full operation, the first generation four months ahead of schedule. And with that we beat our historic records in case of capacity of delivering investments will be (00:03:04) in terms and times and according to our commitment.

In addition to investments in Generation, we had the beginning of a new cycle of investments. And the kind of investments that we had in 2018 were important for the first distribution plant in our portfolio. We started the transmission up for the Espírito Santo lot in December 2018, 20 months before the regulatory schedule. So you see that our strategy is to replicate in Transmission our performance in the area of Generation.

This cycle of investment is completed and in addition to investments in Transmission, we had along 28 specific events as I mentioned in Distribution. And the highlights here I would talk about the reinforced investments that we made along EDP's Espírito Santo and EDP's São Paulo in two times the RRQ which is really significant in terms of investments in these two areas. And obviously the impact of these investments are going to be felt in the tariff reviews of 2019, in August - 2019 in August and November. August Espírito Santo and November for EDP São Paulo.

Together with that reinforcement, we had a geographic expansion in Distribution. And as you followed in the last year, we became a strategic investor in Celesc from Santa Catarina with a higher share in the company's total capital. Today, we have 23.56% of Celesc and we take active part in the company management and governance. And I'm going to talk a bit more about that further on.

In Transmission, just to remind you all, in addition to the beginning of the operation of Espírito Santo, we continue with the licenses of the lots that we have in Santa Catarina and Maranhão. And also the lots in between São Paulo and Minas Gerais, sold licenses. The process is continuous and we expect these projects to follow the regular schedule, as we have been doing the first with Espírito Santo and the hydroelectric plants, as I mentioned before.

And finally, just a quick note on our going into segments that we consider future segments that we are betting for the growth of the company for the coming years. Particularly solar energy, we are investing heavily on solar for the Distribution. In the year of 2018, we closed sponsored (00:06:39) contracts with the Banco do Brasil, of a plant with the 16-megawatt site (00:06:45) in the state of Minas Gerais that will supply to 88 agencies of Banco do Brasil in Minas Gerais.

And so, this is an area in which we are going to make recurring investments in our business development plans. So it's a new area that before we had no history of investment. Also, another note on electrical mobility, this is a segment that is becoming more appealing and we believe it will gain momentum in recent years. You know that we implemented the largest electric charging corridor in Latin America in between the two

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largest cities in terms of population in Brazil, São Paulo and Rio de Janeiro, and we had the partnership to implement this corridor.

Well if you allow me, we are going to page 4. I already mentioned a summary of Generation, but anyway we delivered Jari in 2014 with - 2013 for five months (00:07:51), Cachoeira's Caldeirão in 2016, eight months beforehand and now São Manoel, the first generation with four months before our schedule. In addition to very good performance in construction that we are also replicating in Transmission, we have our operating excellence. Lajeado was rated by ANEEL in 2018 as the best plant in Brazil with the highest score in security, environment. And thus, for us, it was a reason for great satisfaction.

On page 5, I would like to give you a word about risk management. You are all aware that this is an area that has been calling our attention when the Brazilian energy scenario became very particular due to the drought periods that we are having in recent years. So this has been a core point in our business strategy. So in previous years, in 2017 and in 2018, we once again had the need to have almost full hedge of hydrological risks.

And you see on page 5 that the impact of hydrologic risks in our operation would be close to BRL 6 million (00:09:23) if it weren't for the hedge. And last year it was BRL 662 million. So I would say the energy scenario in terms of economic impact was very clear and very similar in 2018 and 2017. And so, we used the same tools and the same instruments that we used in 2017 in 2018, that is, the impact of GSF, additional hedges that we bought in the market with an impact of BRL 92 million and the natural hedge revenue, the portfolio of our plants that are decontracted, BRL 334 million. Altogether, that accounts for 17% of our energy portfolio that is decontracted. So that was the strategy in 2018 basically to hedge for the hydrological risk.

In addition to the Pecém Hedge of BRL 22 million and BRL 187 million of results of synergy between EDP Generation and Trade, BRL 168 million in 2017, BRL 187 million in 2018. And that what draws our attention really, are basic situations that we have to prepare for. You know the fourth quarter we had fluctuations of PLD that has an impact in the market. And then you will see that in the results of the fourth quarter of 2018, we had a marginally negative hedge results and in the Trading Company, we had the results slightly below that of last year.

This is normal. It's seasonal. It is expected due to the volatility that we see in the spot prices in the Brazilian market. Therefore, our hedging strategy is a strategy for the whole of the year with continuous adjustments in our positions compared to the market evolution. So I would like you to take into consideration that the fourth quarter 2018 is basically normal to reflect the market volatility. Now, the year, the whole of the year view which is important for our strategies, we once again had a year of full hedging in terms of our GSF risks.

For the year of 2019, we are also prepared with our portfolio of 15% covered for the market. And as I mentioned this amount may be adjusted due to the market evolution and this is basically what is going on. We always have marginal moves to optimize the hedging of the company as a whole.

I'm going to page 6 now just to give you a bit more color on Transmission. In here, as I mentioned, we started up operations Espírito Santo 20 months ahead of schedule. In Santa Catarina we have already licenses for half of the line together with a substation that will happen 12 months ahead of schedule compared to what we had in our business plan. And we still have the pending part of the line which we expect to have license for very soon. The work has started in the substation in Santa Catarina.

Going down, we are going to Maranhão, going down in our slides not geographically but anyway Lot 07 is in the issue of the installation ongoing and Lot 11 we already have the license okay, 12 months ahead of schedule and the work started. So Maranhão in Lot 11 and Santa Catarina in Lot 21. And for the São Paulo/Minas Gerais line, we have again a process in progress for our installation license and everything is according to schedule. So this is the picture that we have today. So this year, we have a very important situation in terms of CapEx. We expect more than BRL 2.5 billion in terms of the CapEx, close to BRL 3 billion. And so the main reason are the work - the transmission work that we have in all these lines.

On page 7, I would like to focus a little on Distribution investments and the reflects of these investments in our performance in terms of fighting frauds. You can see in the red line, both in São Paulo and in Espírito Santo, the line is crossing the black line. This basically shows for the first time in our history, that we crossed the line and we are below the regulatory goals. And this is a clear evidence of our efficacy in the allocation of capital in Distribution. So we have the tariff review now in 2019 for both distributors. We are obviously expecting an increase which is par - on par with the investments made in the Distribution companies. We also expect to see an increase of Parcel B because of these investments. And so we believe we have all the conditions to recover the investments made in the previous tariff cycle, this tariff cycle that is current today.

Both distributor companies reached the target of two times the RRQ, this is the first time. We always were very close to that. We were very close to the integration level with doubled at the investment in this year and we are going to have a clear reflects of that, advancing in the regulatory bid (00:16:03) of both distributors in the year of 2019.

Going to the next page, page 8. I'm not going to go into much detail. But just to tell you that we continue to be fully committed that this is a very good market. The market understands that and we are fully convinced that Celesc in Santa Catarina has an extremely appealing market with economic growth.

We are opening new investment opportunities through the presence in the state in Transmission and in energy services and transmission per se. And obviously, the investment conditions that we had were quite particular. So, even with the expansion of our share, buying the share of Previ. And later on, the acquisition of some preferred share batches. And even with these acquisitions, we are today at a very comfortable level.

And you'll see that the transactions that are taking place in the market are not as appealing as us. We were able to have a very good profitability and quite a difference, really setting itself apart from what we had in other industries, be it in Transmission or

Generation. So, for us, that was one of the key points of 2018 (00:17:58) and we continue to be extremely confident of the strategic value of this acquisition for EDP.

Well, that was a brief introduction. Now I'm going to turn the floor to Henrique Freire to give you more color on the numbers of the quarter and the year and I'll come back for the Q&A session. Thank you very much.

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

Good afternoon, everyone. We are going to start on slide number 9. And here, we have our net income and the - a proposal of dividend payout. We have the record results as we already mentioned of BRL 1,273 million growth of 108% in net income. Last year, we had the sale of our assets that added BRL 374 million. And adjusted net income without those effects and the accounting effects of Transmission, we still would have a result of BRL 950 million, 66% above that of 2017.

This result shows, again, how important our strategy has been. We have the payout of interest on equity and the payment of income tax. And therefore, we had a growth in the payout of dividend going up to BRL 476 million about 30% above last year and a payout of 50% of the net income, the adjusted net income. So, again the historic results with a historic payout of dividend with a yield of 5.3%. For 2019, we have a very challenging year of investment. We have approved a BRL 2.9 billion in investments and the dividend payout fit the strategy of what we have.

On slide 10, we have the breakdown of our gross margin for 2018. Just showing the evolution of each of the lines. We had growth of about 9%, altogether with a highlight to Pecém. In Pecém, we had growth of BRL 125 million compared to 2017 Energias (00:20:56) ahead, a gain of BRL 22 million in the whole of the year. And the penalties for availability that we carried in previous years was a difference to approximately BRL 90 million this year. So, in 2019 we are not going to have any penalties. Distribution with an increase of BRL 111 million, BRL 55 million in Espírito Santo and BRL 55 million in São Paulo. The highlight here for the market with growth about 3%. Commercialization increased about BRL 36 million, losses (00:21:48), BRL 37 million of gains compared to the previous year. And over-contracting in 2018, a gain of BRL 23 million, particularly in Espírito Santo. So we still had a positive growth compared to 2017. And as Miguel, mentioned record results with EBITDA of BRL 161 million (00:22:18) this year and results of BRL 25 million, compared to 2017 according to the new accounting rules.

Now on slide 11, we have an analysis of the quarter. Well, in hydro generation, we had a reduction of PLD in the last quarter with the acquisition of GSF. So - and what we see in Distribution in the year, we had a gain of BRL 92 million. And in this quarter, we had a loss of BRL 9 million. And still it was a positive result because Generation itself had positive gains.

As for Pecém, we had a reduction of BRL 9 million. Two effects contributed to that. First, positive effect is something that we have talked about, our coal logistics with investments that were progressive. In the last quarter against 2017, there was a reduction of BRL 17

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million. And in energy, we had for the quarter, a loss of BRL 30 million and in the year, we had a gain of BRL 22 million. So, the effect was just the difference.

In Distribution, we first see growth. In São Paulo, it grows about 10% from BRL 2,017 million to BRL 2,041 million (sic) [BRL 217 million to BRL 241 million] (00:24:31) in terms of margin. And in Espírito Santo, we see a drop of BRL 232 million to BRL 217 million, which is basically explained by over contracting. It started with 107.5% in the beginning of the year. There was a market fluctuation in the last quarter.

You know that this happens. And in the third quarter, we were expecting a 108.5% and it went to go to 107.5%. So, a drop of 1 percentage point. That associated to the drop of spot prices in the whole of the year, made this difference in this quarter with a drop of BRL 44 million with gains of BRL 35 million along the year and this quarter BRL 44 million minus. So when we compare, in percent, we have a drop of 14% in terms of margin, but BRL 44 million are explained by the effect of over contracting. So it's no surprise that we have that, and it is normal in this segment. At the Trading Company as we explained, we had - because of the drop of spot prices, we also had an oscillation of margins that accompanies this drop but in the whole of the year, we had a margin of BRL 26 million. Remember that the last quarter, we had a surprise in the market because of the drop of prices.

As for costs on slide number 12, we have the PMTO in the whole of the year. And this is important, I'm going to talk about the quarter later on but I would like to talk about the year in this chart. In the last quarter, in the early retirement plan terminations, we had about BRL 20 million and this BRL 20 million are plus BRL 15 million compared to the previous quarter and plus BRL 12 million compared to last year. And also, we had about a difference in terms of Transmission costs (00:27:13) as well. But anyway, when you're talking about the recurring PMTO, that is removing the retirement program and things that are more connected to a specific project and not to the whole of the structure, we would have growth of 0.4%. The early retirement program, if it weren't for that we would have growth of 1.5%.

Now if you think of the quarter we would have growth of BRL 268 million BRL 298 million that is quarter-on-quarter, an increase of BRL 20 million. Some effects that are important again for this quarter, we had extra work. We had some imaging sea work (00:28:17) in Distribution that led to increase. This is normal but it can happen quarter-on-quarter. We had an increase of costs with some increase of BRL 2 million and IT costs as a whole gave us a chop (00:28:46) of 3% in IT costs but in this quarter there was an increase of 2%.

Again these are things that happen and we are engaging our efforts in terms of services and that translates into a campaign that we are having more with the customers. But anyway, those three events accounts for BRL 10 million of the BRL 20 million of increase. So, if it weren't for these effects, we would have a much lower difference. This is a normal seasonalization that happens to the markets. We have our costs under control and we're having results that show that we are increasing costs way beyond - below inflation. And remember that the efforts that we had from the zero-based budget already gave gains of BRL 266 million from its start.

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And as for the PECLD, this is a scenario that continues to be challenging. We still have a very limited growth of economy, still problems with employment levels, but still the number continues controlled and we have a PECLD at about 85% of - 0.7% of our parent (00:30:32).

Going to slide 13, we have the evolution of EBITDA per business. We closed the year with growth of 26.6%. In BRL 408 million, we have Transmission, others and eliminations. And if it weren't for this effect, we would have growth of 9.4% in our recurring EBITDA. And you see here in the breakdown of results, our results in all businesses are improved in terms of EBITDA.

On slide 14, we talk a bit about our debt and capital structure. We are keeping high leverage about 2.5 would be our covenant, our limit in the Brazilian market and we are basically close to 2. If you think of the year of 2018, we had the sale of the small hydroelectric plants worth about BRL 600 million for the year at 2.6 and then we would have an EBITDA - net debt EBITDA ratio at about 1.6.

What is important to highlight here is that in the upper-left corner, we have our leverage that tends to go down. We had about 7% in 2018. Also important is the risk of financing that is extending maturity is something very important and we see that and we are not only following the cost of our debt that has been going down in the market but also based on our strategy to diversify our debt, we tend to reduce these costs.

It's always a challenge but we have already completed financing with Lots 24, 21 now in the last quarter and Lot 11 with BNB, the Bank of the Northeast in the end of the year. In the weighted leverage, we have 95%. Lot 7 we are negotiating in Maranhão with BNB and Lot 18 with BNDES or whoever can provide better interest rates. So the total estimated leverage in Transmission should be between 80% to 90% of our CapEx.

So now I'm going to return the call to Miguel.

Thank you, Henrique. Well, just to close before we open for your questions, on slide 14 or 15, we basically show you that the year of 2018, according to our drivers of the strategic position, we chose these five pillars: double-digit growth, distinctive execution, de-risking of our execution, discipline in the allocation of capital and financial discipline, and to be technology driven.

So these five pillars were the pillars of our strategic plans and showed results in 2018 and we had significant advances in each of these pillars. 2019 is a year that we expect, as we mentioned before, a deployment of CapEx of approximately BRL 2.9 billion. We, as you know, are expecting the tariff revision of our distributors. This is a year for us to execute those CapEx, we have to complete all the projects contracted and evolve in the construction process. And remember that we always want to have on time, on core (00:35:37) performance.

With regard to risk, we are going to continue to have an active management of hydrological risks and that has been enabling us to mitigate bad impacts in our operations.

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And together with that, we are able to preserve a controlled exposure in the Trading segment. We know that right now in the current scenario, (00:36:08) to the point that this is (00:36:10). As you know, EDP is a company that takes a very conservative tactic management with regard to risk, and we want to continue to restrict our risks to guarantee that the current market scenario does not affect our operations.

Financial risks controlled according to our debt covenants, financial discipline. Obviously our commitment is always to reduce costs and to have costs below inflation as we have been doing in recent years, which enabled us today to gain efficiencies at about BRL 260 million with costs of about BRL 1 billion (00:37:02). So, the efficiency that is being brought by these programs is very clear. So, really, we want to continue with selective, and selective is very important here, selective investment opportunities as we did in Transmission that is taking significant investments now.

And in terms of technology, we want to continue to investing in smart grids. We have a pilot project in Espírito Santo with more than 50,000 clients. We also have investments in AI. New investments in our back office operation but also front office operation, and a new investment that we are making now in solar energy - distributed solar energy. So this was a very brief summary of what we expect for 2019.

With that, I thank you very much for your attention. And we go back to the operator for us to start our Q&A session. Thank you very much.

Q&A

Operator

Ladies and gentlemen, will now start the Q&A session. Any questions asked in English will be answered in Portuguese and translated simultaneously into English. Our first question comes from Thiago Silva from Santander.

Q - Thiago Silva {BIO 22071118 <GO>}

Good afternoon and thanks for the call. I have two questions. The first was manageable costs, especially expenses with personnel and third-party services that had an increase year-on-year. I understood when you talked about the retirement program and so it's very clear. But I would like to have a bit more color if that is to be expected for this year as well, if you want to decrease this line furthermore or if it's going to be cast in the same light (00:39:41)?

And for third parties the same, the explanation is that you had consulting, legal services, if you're expecting to have them all in the year of 2019. Second question is with regard to growth, not only growth as you had by buying share in Celesc, do you want to increase even more your share in those assets or are you interested in enjoying this window of investments and going into Generation for instance, acquiring other assets or even going to the Distribution segment? So, basically to understand if you have this mindset of growth in other segments. Thank you very much.

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

Hi, this is Henrique Freire. Well, if I understood your question in terms of costs is if we expect them to be maintained. We know as I mentioned that our commitment has been to continue to reduce our cost base below inflation levels. This is the commitment that we have. We see costs that are just normal fluctuations that may have - may show quarter on quarter. For instance legal services it's something that we had an increase in the quarter but this is basically part of the natural fluctuation and volatility that we have in between quarters. The retirement program is critical for us to evolve our costs below inflation and we continue with this drive. What is important is to guarantee that we are going to continue with costs below inflation.

If in effect (00:42:12), I haven't answered a question and you want to know a bit more, you can contact me later. About growth, I was very careful when I said that we are paying attention to opportunities in the market and I did mention that we are selective in terms of investments. So we have lots of studies going on about possible investments in segments that we consider strategic. In Transmission, we were part of the last three auctions and were not successful in the lots that we bid for. I think this is a clear sign of how careful we are with our allocation of capital. Obviously, we would have interest in expanding investments but we are not going to do that without preserving our profitability criteria which are non-negotiable. So, I think it was important, even for the market to understand clearly that the company will not make concessions (00:43:29) with regards to the profitability of its investments.

And so, we have been looking at the secondary market with Transmission projects, projects that are already amortized. We have the contracts that are established and proprietors may be readjusting their investment strategies. So, we are looking into opportunities particularly in the segment of Transmission secondary markets.

Q - Thiago Silva {BIO 22071118 <GO>}

Okay. Thank you very much.

Operator

Since there are no further questions, we are going to turn the call back to our speakers for their final consideration (00:44:48).

A - Unverified Participant

Well, we would like to thank you very much for your attention and remind you that we are in the group (00:45:00) EDP - on March 12, EDP will have a strategic update in London. So, I think it is an important time for the group's strategic actions. And with that, I would like to close and we wish you all an excellent Carnival.

EDP's earnings release conference call is now closed, so the questions taken on the webcast are going to be answered by the IR team. We thank you very much for attending the call and wish you a good afternoon. Thank you very much.

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