

Q3 2012 Earnings Call

Company Participants

- Luiz Otavio, VP
- Miguel Dias Amaro, VP
- Unidentified Speaker, Unknown

Other Participants

- Andre Gaeta, Analyst
- Carolina Carneiro, Analyst

Presentation

Operator

Good afternoon. Welcome to EDP Energias do Brasil audio conference to discuss the results for the Third Quarter of 2012. At this time all participants are in a listen-only mode. Later we will conduct a Q&A session and instructions to participate will be given at that time. (Operator Instructions)

This audio and its slides will also be transmitted simultaneously via the Internet through www.edpbr.com.br/ri. There you will also find a release relative the Company's results.

Before proceeding, EDP Energias do Brasil would like to clarify that any forward-looking statements made during this audio conference regarding the Company's business perspective, as well as the projections, operating and financial goals relative to the Company's growth, are forward-looking statements based on management expectations for EDP Energias do Brasil's future performance. Such expectations rely on Brazil's economic environment, performance and regulation of the electric industry, in addition to other variables. And therefore are subject to change.

I would like to give the floor to Miguel Dias Amaro, VP of Finance and IR in Brazil. You may proceed.

Miguel Dias Amaro {BIO 19148334 <GO>}

Thank you very much. Good afternoon. I thank you very much for participating in our call. As always after the disclaimer I would like to go to page number four of our presentation where we have the highlights for the period. But before we go on I would like to say that we have here in this call together with us our Generation VP, Luiz Otavio. So if you have any questions relative to generation he will be able to clarify any questions you may have.

The Third Quarter was yet another quarter when the cost of acquisitions increased more than the revenues, especially in the disco. And therefore the gross margins had a decrease of 14%. We also had for this drop of margin the -- a loss with the same which was passed to the distributors. With the evolution of costs in this quarter and we see 13% even though in the accumulated 12 months of the costs are below inflation for by 4.8% EBITDA dropped 30%.

And also the costs (inaudible) positive evolution because they were less than the previous period. And also marginally in this semester as this is being closely monitored. As to the net income we had a reduction more than EBITDA due to 6% increase the amortization than the other results. And also due to the increase in generation and participation of minority shareholders.

In terms of net income, the liquidation of a % hedging and other actions. And then when we look at the consolidated net income we see a higher impact and a higher impact. At the operating level I'd like to highlight that losses are decreasing, sales are stable at Bandeirante the indicators have improved for both discos.

In August we had the Escelsa's tariff adjustment of 14.29% and in October ANEEL has approved the tariff adjustment to Bandeirante, which will give us a 7 point and not 29% [ph] combined impact. Also in October (inaudible) started its tent, providing energy to SIN.

Before I turn over to my peers I would like to say that in October we closed the long-term financing for Jari with a six-year term plus two grace periods, to TJLP plus 1.86%. So it's the longest project financed that we've had so far.

Unidentified Speaker

My peers. Good afternoon. I would like to for you to go to slide number five where we see in the nonrecurring fact for the Company the Second Quarter and the regulation effect, or justify the regulatory balance, the position of revenues from surpassing demand and non-recurring events.

EBITDA would be BRL355 million with the highlights for the regulatory assets and liability balance totaling BRL90 billion due to the asset constitution relative to energy purchasing, increase in CLD and higher dispatch from thermal plants.

Slide number six we see a summary of the Company's operating performance. In generation we see a reduction of 7% in the energy volume sold during the quarter against the same period of the previous year. This results is a reflect of the strategy system analyzing power purchasing contract with a higher allocation in the first half of 2012. In the 12-month period the volume is stable. Trading company, the volume of energy increased 14% in the quarter and 8% in the 12-months period. This growth was pushed by the long-term negotiations and by the 13th adjustment auction.

In discos the consolidated consumption was stable the Third Quarter as the increase in consumption for commercial and residential classes was offset by the reduction in the

industrial class. In the 12-month period the growth was 1%.

The Company is still investing in programs to fight losses. It has disbursed BRL9.7 million in the Third Quarter for this purpose. From this amount 4.9% were for operating and investments and 4.8% for management expenses. FEC and DEC from the distributors were within the standards established by ANEEL with an improvement of both indicators both for Bandeirante and Escelsa, showing the Company's focus on service quality or customer quality.

Slide number seven we see the operating expenses totaling BRL1.5 billion in the First Quarter or in the Third Quarter, excluding construction revenue. This amount was 18% above the Third Quarter of 2011. The main determinants were increase of 30% in the average price for commercialization, 35% for generation, a BRL25 million increase in the short-term revenue for energy due to the PLD increase for the period, a net average increase of 10% for Escelsa's tariffs due to the tariff adjustment applied in August in addition to Bandeirante provision, BRL9.6 million due to invoicing for surpassing demand in excess consumption of reactive energy without any effect to the Company's cash flow.

Again our manageable expenses are to be highlighted. An increase of 42% occurred against the previous period. The electric energy bought for resale totaled BRL880 million [ph], an increase of 25 -- or 52% rather, due mainly to the adjustments on inflation, increase of 20% due to the low dollar appreciation, from Itaipu purchases and PLD increases. Due to the increase in PLD distributors considered -- constituted a BRL90 million regulatory asset, potentially recoverable manageable expenditure excluding depreciation, amortization and construction costs totaled BRL236 million, up 13% against 3Q '12, or in 2012 rather.

In the 12-month period we had manageable expenses with an increase of 4.8% in the 12 months. We were below the inflation and total EBITDA therefore totaled BRL245 million a reduction of 30% against the same period of the previous year. The net consolidated financial results were negative, totaling BRL70 million, an increase of 5.7% against 3Q '11.

The financial revenue showed a reduction of financial investment due to smaller cash flow reduction of interest rates, a smaller revenue by Selic's correction. And potentially recoverable social contribution. And non-recurring gains in the ICMS credit at Bandeirante [ph] financial expenses. The main variations were a greater expense of public good news update, a reverse of -- on financial expenses from monetary restatements at relative to interest and fines and repeats. And the higher charges relative to a larger debt balance for this period.

Also there was a depreciation of the dollar standing now at \$2.03 against an 18.8% appreciation which we had in 3Q '11, thus improving the foreign exchange results.

In slide number five we see that the net income totaled BRL9 million, BRL9 million, 90% less than previous in the period, mainly due to higher non-manageable expenses on gross margin.

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Slide number 10 we see the Company's debt. Consolidated gross debt totaled BRL4.2 billion 12% above 2Q '12, resulting mainly due to the BRL400 million debenture. The debenture by Energias do Brasil, net debt totaled BRL3.3 billion in September, an 8% increase against June 2012, an increase in debt. The average cost of the debt for the Group in September was 9.7 per year against 9.4 in June 2012.

The increase in cost results mainly due -- or results mainly from the Selic higher exposure and the average consolidated debt, a decrease of 4.7 years in September 2012. In terms of the indicators at 60% of the gross debt is linked to CDI 35% to long-term interest rates, a ratio net debt 2.6 times, resulting from the reduction of the debt and reduction of EBITDA.

Next we have the investment, BRL239 million 3Q '12 divided in BRL68 million for distribution, BRL172 million for generation. In the disco, the amount included capitalized interest amounting to point billion --BRL0.5 million in Bandeirante and BRL1 million Escelsa deducted for special obligations.

The increase in the special obligations Bandeirante was due to booking, invoicing for surpassing demand in the consumption of excess reactive energy and special obligations in generation. Investments were allocated mainly to construction process, or projects rather, 34% the same and 53% in Jari. The TPP Pecem 1 was in 3Q '12 at 98.7% in its physical progress. The project is currently in the final stages with the synchronization. The plant is now providing energy on a test mode through the national system and it is supported by the sub market of northeast.

After the second unit is advanced stage of commissioning and we have the first burner of the boiler ready fired in the Third Quarter, energy purchased to restructure energy sources after the 23rd of July 2012 under the timeline considered by ANEEL. And the acquisition of energy amounted to BRL74.5 million from which BRL51.6 million were passed on to the distributors.

In terms of Jari, the works are within schedule and the main accomplishment are the launching of the coffer dams, the diversion structures. And as Miguel said, on October 16 BNDES approved financing, long-term financing for the plant of BRL736.8 million with a total timeline of 18.5 years and a cost of long-term interest rates of 1.86% per year.

The first disbursement should start in the Fourth Quarter of 2012. As we have communicated on July 20 -- 31st, rather, ANEEL approved the average annual tariff increase of 14.29% to Escelsa's tariff applied as of August 7. And the average effect received by the consumer will be 11.29%.

Final terms for the third revenue cycle (inaudible) from the recent tariff adjustment was set in October 2012. As we have communicated on October 2nd, 2012, ANEEL approved the 2011 tariff review of Bandeirante in reference with the third periodic tariff review cycle. And therefore the positioning was one -- minus 1.85% in that 2.22% negative were relative to the repositioning. And 0.37% relative to the pertinent financial components.

Additionally, in agreement with the communication to the market on October 17th, ANEEL approved the tariff adjustment for 2012 for Bandeirante to be applied after October 23rd. The tariff adjustment was 11.45% and that 7.60% was relative to economic repositioning. And 3.85% was relative to the pertinent financial components.

In terms of the current tariffs approved for 2010, the average effect perceived by the consumers will be 7.29%. The financial adjustment relative to postponement of the periodic tariff review for 2011 is a value of BRL78 million, was divided into three annual installments in that the first one was included now. And the other ones will be for the subsequent adjustments.

We will now start the Q&A session.

Questions And Answers

Operator

(Operator Instructions)

Our first question comes from Carolina Carneiro from Santander.

Q - Carolina Carneiro

Good afternoon. I would ask you to elaborate on your percentage, especially for the free market, the spot market in terms of price. What are your projections? Do you see an up or down trend, not only spot but derived? But also pressures on the free market derived from TNP [ph]?

And the second question, what were opportunities do you see for the renewable energy segment vis-a-vis what we see in terms of prices and the expectations on 579 MP?

A - Miguel Dias Amaro {BIO 19148334 <GO>}

Okay. We're going to split this answer in two. Yes. The trading company was more attractive in the Third Quarter with some long-term contracts that had good portfolios. The spreads were a little volatile. Today we have a PLT that's particularly high due to the drop -- the lack of range all over the country. But specifically in the north and northeast. In terms of the evolution and price expectations I would leave this answer to be given by Luiz, our VP in generation.

A - Luiz Otavio {BIO 15977792 <GO>}

Good afternoon. As you all know, PLT the energy price named PLT in Brazil due to the fact that we have a hydraulic matrix is made up by the amount of water you store. And this provides for a very high volatility on these prices. So just like in previous years we are now going through a moment of lower water stored. So we have a dispatch of the thermal plants increasing PLT.

The large reservoirs in Brazil are in the Minas Triangle area and in San Francisco River area. The expectation is according to the weather forecast is that there will be some rain. So this should push prices down in the next month. But in view of the positioning of the reservoirs, in spite of the rain, prices should be relatively high, between BRL100 and BRL200. So we have no expectations of anything below BRL100 for the next month due to the lack of water for thermal dispatches.

As to the MP -- the impacts to the market, I'll give it back -- I'll turn over to Miguel.

A - Miguel Dias Amaro {BIO 19148334 <GO>}

Yes. The MP, the provisional measures can have some impact on the market. We have seen no moves so far. There may be amendments still to be made to the provisional management -- provisional measures. So we expect still some debates. There is nothing that impacts us directly in terms of construction because our constructions will be ready by 2025. And in terms of charges I think it's clear to everybody that there won't be an impact to all tariffs in all areas of the value chain.

So the conclusion of the MP -- at is what we'll have to see what are the best opportunities for EDP. So it's working within the profitability margins that are ours. Thank you.

Q - Carolina Carneiro

So just to complement, what about the opportunity for renewable energy? Do you think the market is still welcoming this sort of energy? Or should we -- should it better to wait?

A - Unidentified Speaker

In terms of renewable energy if we consider that renewable does not consider -- if we consider the hydro power we are 100% renewable.

Q - Carolina Carneiro

Yes. But I mean prices, will prices still be attractive?

A - Unidentified Speaker

Renewable energy, what we have in partnership with the wind industry at EDP renewable, we have to bear in mind CapEx, profitability. And the prices and the competitiveness according to the auctions. Of course we are keeping an eye on it. We always want to participate. But we always bear in mind that profitability is something that has to be reached because the delays may have any work and strikes. And some other events that are out of our control. So we will go on keeping an eye on these opportunities, whether or not we have the provisional measure, the MP or not.

Operator

(Operator Instructions) Our next question comes from Andre Gaeta from Goldman Sachs.

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Q - Andre Gaeta {BIO 16153198 <GO>}

Good afternoon, my Martin [ph] and Miguel. I would like to ask about the capital structure. Slide number 11 you highlight that the leverage has increased, has progressed twice. So 2.6. This is a result of the short-term EBITDA strategy. But of course for 2013 you see positive signs of a recovery of EBITDA for the Company. And also if we consider the 2014 when Bandeirante should surpass the levels, how do you see the capital structure for the Company in terms of 2013 and 2014?

Should I consider something about 2 times, 2.5 times, or to consider the situation of this quarter? Is it a one-off or a situation, a consequence of all these points that you have highlighted here with especially the absence of CDA? So how should I consider the projections for the Company for the next month?

A - Miguel Dias Amaro {BIO 19148334 <GO>}

I'd say that you should consider two to 2.5 times. I think this would be a reasonable amount for (inaudible) net debt EBITDA. We are being impacted by the energy costs. We will rely on the amount of rain to see the amount of thermal plant dispatch, which will or will not have a higher impact on cash generation for the fiscal flexibility with the adjustment of Bandeirante and the regulatory asset. I believe that 2013 will be more comfortable in terms of cash generation.

You see in the release that last year [ph] do an investment have already settled the debt, BRL115 million that were still outstanding. So there also we see a capacity to better adequate the capital structure. In terms of distribution also I see an evolution in consumption. And if you consider that our GDP and results should close the year at 1.5% this is what the market expects. The industrial production is relatively slow, in Espirito Santos consumption is a bit stronger in October. Therefore, we still will have some pressure on the distributors' margins.

Even November we'll see some recovery and December. Then for 2013 if you work with this capital structure you would be within the parameters that we aim to reach.

Q - Andre Gaeta {BIO 16153198 <GO>}

One second question if I may concern something that we talked about in the last call, just talked about the auctions A minus 3 and A minus 5. Could you update us, because now I think it's very clear that the government will choose A minus 5? I would like to know how you intend to participate. Have there been any changes vis-a-vis the projections that you had in the previous call?

A - Unidentified Speaker

Well the auctions A minus 5 and A minus 3 in December usually turn very much into A minus 2 and A minus 4 because you don't have time for their execution. And this is relevant I believe. But yes you in concrete terms, apparently A minus 3 is not going to happen, A minus 5 -- this has not changed our expectations.

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We still are looking forward to a project with some challenges, mainly relative to environmental issues. These challenges are material challenges, not small challenges. Therefore, this is something that we have to pay very close attention to. This doesn't mean that we're not considering other alternatives. But it's still something that we are discussing internally.

Q - Andre Gaeta {BIO 16153198 <GO>}

So it means that you are working with a small wind participation and a share of 51% in the 400 mgs projects. It's not 51%. It's 50/50

A - Unidentified Speaker

Okay fine. Already in the consortium model identical to what would it would be in terms of energy share and all that.

Operator

(Operator Instructions)

A - Unidentified Speaker

If there are no more questions our audio conference for EDP 3Q '12 results will now come to an end. Any other questions will be answered by the IR team. So thank you all for your presence and have a very good afternoon. Thank you.

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