

Q2 2015 Earnings Call

Company Participants

- Henrique Freire, Chief Financial Officer
- Miguel Setas, Chief Executive Officer and Investor Relations Officer
- Unidentified Speaker

Other Participants

- Maria Carolina Carneiro, Analyst
- Paulo Ferreira, Analyst
- Unidentified Participant
- Vinicius Canheu, Analyst

Presentation

Operator

Good morning and welcome to the conference call of EDP - Energias do Brasil, in which we are going to discuss the Earnings of the Second Quarter 2015. All participants are in listen-only mode. Later on, we are going to open for questions-and-answers when further instructions will be provided. (Operator Instructions).

This presentation together with the slides (Technical Difficulty) simultaneous webcast on the website www.edpbr.com.br/ri. In there you can also find the Company's 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 relative to its prospective growth are based on forward-looking statements based on the Company's expectations about the future of EDP Energias do Brasil.

Forward looking stations [ph] depend on the country's performance, the regulation of the electric industry, in addition to other variables and therefore are subject to changes.

Now, we are going to turn the call over to Mr. Miguel Setas, CEO and Investor Relations Officer of EDP. Please, Mr. Setas, you may go on.

Miguel Setas

Good morning everyone. I'd like to welcome you to this conference call relative to our earnings of the second quarter 2015. Straight [ph] up here with me today, we have our

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CFO, Henrique Freire; and also our Finance and Relations Financial -- Officer, (inaudible).

Before going to the presentation itself, I'd like to talk a bit about the special moment that this quarter represented to us. As you know on July 13th of 2015, EDP reveals its public stock option in the market of the stock exchange of Sao Paulo. And therefore in 2015, we are turning 10 years in the Sao Paulo stock market.

I wouldn't like to let go this opportunity without thanking our investors, shareholders that are following our stock. I thank you for the dedication along this ten years that enables our Company to develop significantly. This two indicators that I would like to highlight in this period of 10-years is first, our stock exchange capitalization, I remember that 10 years ago when we had our IPO, our market cap was about R\$2.9 billion and yesterday our market cap was R\$6.1 billion, so in about 10 year, 10 years more specifically we had more than a 100% valuation of our stock quote. In this period we had a payout dividend that was about more than R\$2.7 billion including the dividends to be paid out in 2015.

So, in our point of view, it is a history that is quite positive. This history was followed by the development of the Company itself. And then I would like to mention an indicator that despite representative about the growth of EDP Energias do Brasil, in 2005 we started our presence in the stock exchange with 530 megawatt sub-installed capacity.

And we communicated to our investors and shareholders that we had the intention of growing the business of generation. 10 years later, we have a portfolio of 2.7 gigabyte of capacity which represent an evolution of five times what we had in 2005 where we started this period of 10 year. Therefore I would like to start our conference call today mentioning how important this period was to us and also thanking you all for following us and investing in our Company.

And now we are going to the presentation itself. And I'm going to open the presentation on slide number five. To talk about the highlights that we believe are most relevant in this period of the second quarter 2015. On the slide, I would like to talk a bit about the context that you all know about this information, but it's important to remind you that we continue with a very low rainfall. As you know reservoirs in the Southeast where we have 60% of the country's installed capacity. We have very low levels compared to last year. And that compared alike to a market situation of 2%, 3% in the last month with respect to possible risks of a energy rationing.

So this two variables show that although rainfall is below what we expected, it is slightly better than what it was in the past. And also we had a decrease of demand in the national market. Of course, this has reflects on GSF, that is close to 81% justified by the preservation of reservoirs and electric power plants. For us (inaudible) 2016 with a better energy situation.

But you all know in terms of rainfall what is going on. I don't think that we have to talk much more about that. We are all struggling at the scenario.

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There are price points that I would like to highlight in this presentation. The first is the consolidation as an integrated operator focused on thermal plants and also extending on energy services. I am going to talk about that on next slide. The second point is our commitment to execution, that has to be an execution of excellence in the case of the various project [ph] that's going on. We translated this execution in controlled budget and by sticking to delivery time. And again when we talk about our two hydropower plants Cachoeira Caldeirao, Sao Manoel we are going to talk about that.

The third we call the turnaround of Pecem. We know that the thermal power plants of Pecem at the beginning of operation in the first two years below expectations and now we believe that we have reached the operational maturity of this plant. And we start to see the economic financial reflexes of that. And also we are going to see that along the presentation.

Also the fourth point is improvement of our operational results. Basically it is reduction of non-technical losses, surface levels better in distribution and also a control of costs, our policy to optimize cost that our CFO is going to talk about with the results of this quarter.

The first point I would like to mention is what I called the mitigation of risk factors where we talk about the credit risk with all the measures that we are taking to curb commercial losses and delinquency, also the energy risk. So focusing on the volume of energy that we have different prices in for 2016. And the mitigation of financial risks and our CFO is going to talk a bit about our financial policy, our cash management policy that makes us to take a very cautious position that is the most suitable for the time we are going on right now.

So now, we are going to slide number six, to focus a bit about the point that I was mentioning in the previous stage. As you can see in the second quarter of 2015, we completed the three transactions that make sense to extend our presence in the energy sector. And I'm going to mention them very briefly.

The first is the acquisition of 50% of Pecem I. This was carried out in advantageous situation R\$300 million, which accounted for the 50% of the book value of the plant. And because of the revaluation of this asset, we see a difference of the value of acquisition in the book value. But also from book values to market value. And with that, we had a positive impact of R\$885 million in our EBITDA. Of course, this is a factor that determines largely a very positive result in the second quarter 2015.

Also, the second operation is acquisition of APS, a company with 23 years of experience, revenues close to R\$20 million more than 600 customers and we believe that it make sense at the current moment we are going through because we have high tariff and this is a need of our customers.

We believe that with that we are going to have a better market. We believe that market of energy sufficiency may grow by R\$1 billion between 2015 to 2018 and we are positioned as an operator that is highlighted in the market that's 10th out in the market. And the third operation is the sale of Pantanal Energetica, this company had two small hydropower plant in Mato Grosso do Sul. This two small power plants had amounted to

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assets that today if we think of operations with the departure of (inaudible) made no sense to us. And therefore this movement justifies our optimization of portfolio. And it makes sense in terms of efficiency and it is an operation that wanted to reduce Company leverage with the sale value of R\$390 million in the end of this transaction.

So these are funds that can obviously help fund the Company in its other operation. And it's very interesting to think of those amounts of the purchase of 50% of this thing and the 390 million of the sale that will enable us to pay for the acquisition of Pecem. Going to the next slide, slide number seven, here the highlight are the second point of our initial opening which are our commitment to execution and here we show the evolution of the two plants that are being constructed, Cachoeira Caldeirao with 85% of accomplishment and Sao Manoel in Mato Grosso, in the State of Mato Grosso, Brazil with 700 megawatts.

We have a partnership with two other partners with an evolution of 15%. This physical development of these plant make us believe that we can even deliver this plant before time. We think of 6 months to 12 months. And with that, we are going to repeat the experience of Santo Antonio do Jari [ph] where we advanced operations by 3.5 months. And with that we saved cash resources, so 3.5 of Jari was equivalent to the first year of activity of (inaudible) which obviously brings a relevant impact in the performance of the Company. Cachoeira follows basically the same line, Sao Manoel is a bigger execution and we don't know, if we are going to be able to advance that. It's still too early on its time.

With that, I'm going to page eight, talk about the third topic of our initial slide, which shows what we are talking about as the turnaround of Pecem I. As you know, in the first two years, we had an availability of 62% in 2013 and 76% in 2014, below the regulatory level of 80%, and now in the first half of the '15, we have 88%, which is a level close to the 90% that we expect to reach by the end of the year.

So operationally speaking Pecem has an evolution that consolidates the plant in terms of activities and financially, this has a -- this maturity has a reflex and we can see that the accumulated EBITDA for the first half of '15 is R\$142 million against the first half of '14 of 81 an much above the first half of 2013.

So we are going through a stable operation of Pecem, a regulatory optimized operation, we have been talking a lot about that with analysts and investors showing the advances that we had in terms of our regulatory scope. And obviously, the reflects of these improvements are already showing in positive economic result.

We are going to page nine to talk about the improvements that we have had in distribution. I'm not going to be too detailed on that, you have the information in our release in detail. But we show a positive evolution in the back pack of both distributors. And also, a consistent evolution in terms of non-technical losses in our distribution companies in Bandeirante, in Sao Paulo, a reduction of 1.18 percentage point and in the (inaudible) Espirito Santo a reduction of 1.45 percentage points. So you can see that is, Sao Paulo, we are gradually closing to our regulatory mark. In Sao Paulo, we reached our regulatory mark and Espirito Santo we are getting closer to Enel's target. On the next slide, going into risk and the mitigation of risk, I referred to in the first slide, so here what

we are showing is the evolution of our delinquency, I'm sorry the allowance for doubtful accounts compared to our growth revenues.

So you can see from 2013 to 2015 you have an increase of distribution companies, because of tariffs increase, but we are within the historical levels of the Company. So, we are not completely done with that. We are going up, but we need a bit more time to have stable amount.

For now, what we see right now is that, this we are still above historical levels in both companies, both EDP Bandeirante and Escelsa. We have reassimilated our collection actions; we are working with more programs to fight losses. And with that, we are containing the factor in what we consider a regular period of time.

Going to slide number 11, I referred to what I mentioned in terms of energy risk. And here I am just remind you that, as of 2016, we are going to have the decompressing of Enerpeixe and with that we are going to have a volume of energy that we can be used as a natural hedge of our energy position in the GSF scenario that we have been following in recent years.

And therefore, on this slide you can see 80 contracted level of energy between 19% to 21% in the next five years, which will give us the flexibility to have risk policies that will assure us a natural hedge against the energy risk. So we are going to have a very positive flexibility. That obviously does not rule out any other solutions to mitigate at least partially the risk that we have with GSF, that the Ministry of Mines and Energy, and the regulators are talking about. So we're still waiting for the evolution of their decision, that's based on that we are going to have a strategy for energy hedge with the flexibility of the decontracted energy. Of course, everything can be changed according to regulation.

Well, with that, I've finished the first part of the presentation and I'm going to turn the call to our CFO, Henrique Freire.

Henrique Freire {BIO 19117781 <GO>}

Good morning, everyone. So, considering the presentation, I would like, expect you to go to slide 13 where we talk about indebtedness and our debt level. Starting in terms of disbursements we have a total of 771.5, 300 million in the holding with mission of CCB in Banco do Brasil and then distributed 250 million reference to 431, with the bill of exchange, a 150 million for Bandeirante and 100 million for Escelsa.

As for the BNDES, the contract signed until the end of 2014, we have a source of 108 million, first disbursement in 2015. And then an addition of 221 million for -- saw a 108 for Bandeirante, 113.5 to Escelsa. So this is along 2015 and 2016.

As for the project that are still ongoing, I'd like to highlight Sao Manoel with a bridge loan with BNDES of the 450 million with the first disbursement of 265 in the third quarter is going to be the remaining amount.

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As for consolidated numbers, we have an increase from December '14 to June '15, R\$3.2 billion. This is due to the consolidation of Pecem that is going to be consolidated -- that was consolidated until May '15, so this is already showing a contribution of 2.4 billion in this increase. If we take a look at our cash, in this evolution, we have 1,635 million and in this amount we have 88 million that were received with this partial sale of EDP Renovaveis. As for EBITDA net debt, we had an increase of 1.8 times within the parameters that are considered reasonable.

Now we are going to the next slide where we analyze our gross margin for the Company. This information is showing in distribution generation and commercialization, distribution we can see that gross margin had an evolution of 372% that basically because an asset that was not recognized in our lines in IFRS.

If we take a look at generation, we had some effect that were recurrent, but there is an evolution of 183 to 246. With that, we had the consolidation of Pecem of 45 days and we have 89 million of contribution of Pecem. And we have an effect of GSF that had a negative impact of 73 million. So we have a small hedge of 15,

which gave us a gain of (inaudible). We have 17 million of over contracting for Bandeirante going back to distribution. And therefore a 105% this energy gives us a gain for the Company. As for commercialization, we are keeping a positive evolution in our gross margin.

And now going to slide 15 where we show our PMSO expenditure. On slide 15, the first part of the slide, we show the quarters and the bottom part we show the first six months. So quarter-on-quarter, we can see that we had an evolution of 14% above the inflation of the period. But if we remove Pecem from the contribution, we are more or less in line with the previous quarter. We have very strict control of PMTO. If you think of cost with personnel, we are keeping the same number 95, 95.

And if you take a look at distribution isolated, we had an evolution that is minus three percentage point to the inflation. As for our consolidated numbers, on our EBITDA on slide 16, you see that the Company went from an EBITDA of 430 to 1,222 million. So an evolution of 184% in the period. We already talked about the effects of gross margin, the inclusion of Pecem, and also we had PMTO that had a negative impact and then we had 477 million, which is the gain in the sale of assets. Remember that in this period, we also had a gain in the sale of Cachoeira, Jari and here we have the contribution of Pecem.

The first has to do with the work of consolidation, the consolidation of our business has of course respecting the rules that we had an independent report by Ernst & Young validated by KPMG and PricewaterhouseCoopers. And we have a consolidated net income of 774 million. And we had the discount of 300 million when we made the acquisition of Pecem. So we had a consolidated effect here. As for our net income, as I mentioned, because of all this effects, we had an increase of 300% going from 184 million to 744 million. Again I'd like to highlight that, we have a deferred tax that has to be answered because of our operation.

Now I'm going to turn the call back to Miguel Setas that is going to talk a bit about the tariff review for EDP Bandeirante.

Miguel Setas

Well as you know, we had a public hearing for the tariff cycle review on last 28, until the 23rd of October, we were going to go through this period where we are going to have the negotiation to come to the final tariff. But on page 18 of our presentation, you have the main factors that are being considered to get to our tariff. A bit about Parcel B, the proposal in the public hearing was that to have R\$798 million.

This amount is a drop of 3% compared to the current Parcel B that we had in the tariff that were in effect for 2014 on and this amount is an amount that is comparing positively with a decrease of 20% that we had in 2011 when we started the third tariff cycle.

So this is a positive message. Other data, that is interesting for you to know, is an increase of our growth regulatory asset base from 3 billion to 3.36 billion.

So again a positive evolution in our gross RAB. And net as well from 1.5 to 1.68. So both bases gross and net with positive evolution. As for operational cost that are included in Parcel B. These are close to the amounts that they were in the previous version of the tariff. So 415 and this amount, as you can see in our financial statements is an amount that is above the operational cost of Bandeirante on an annual basis. So shows that the Company is having a positive evolution in the terms of use of its operation. I'm not going to talk about each one of this line, but I would like to remind you all that the amount, the average amount is about 11.65%. And therefore this is the base that we are going to work within the next week, so that we can get to October the 23rd with a final tariff implemented.

But our position is that this evolution was the growth of the fourth tariff cycle review is positive and enabled distribution companies particularly our Company, Sao Paulo to have a tariff review that seems to be suitable and clear compared with activities. So we believe that the proposal that is right now being negotiated in the public hearing is very interesting.

With that, I'd like to close this presentation and open for questions-and-answers.

Questions And Answers

Operator

Ladies and gentlemen we will now start the Q&A session. (Operator Instructions). Our first question comes from Credit Suisse, Vinicius Canheu.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Hello. Good day, everyone. Thanks for the presentation. I have a question about management of generation. The slide shows a mitigation of risk and you have a very interesting position for the next years. What we wanted to have, is it going to be around 20%, do you plan to sell parts of that? I would like you to give a bit more detail for us to know how you're going to manage your three capacity. So we have seen, your provisions for bad debt going down, I think you're having a better risk. So how are you going to manage this capacity?

A - Unidentified Speaker

Hi, Vinicius, good morning and thanks for your question. Basically right now, we have two variables that are going to determine our strategy. In terms of (inaudible) energy risk, first is what is going to be defined for GSF. We do not want to close the position before we know exactly what is going to be the proposal of the Ministry and of Enel to mitigate the risk of GSF. So we are waiting for this proposal to be clearer in the coming weeks. And with that, we can have a more definitive position in terms of our portfolio.

The second consideration I'd like to make is that, despite the reduction of provisions of bad credit, we wanted to increase, I'm sorry, spot prices, we believe that spot prices are going to go up.

We believe that the spot prices are not going to be below R\$200 in coming years in a consolidated manner. So obviously, this 20% enables us to have a very significant hedge, but we haven't come to a decision in terms of how much we are going to have in terms of coverage of risk, so that is for hedge. But I would believe it would be about 10% working with GSF of approximately 90% and a hedge of 10% would be the most expected hedge in our strategy. But as I mentioned, this is a decision that is still being analyzed internally. And this 10% is just a reference for now. Basically (inaudible) 20% seems to be too high, so our decision probably is going to go to a lower amount.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Okay, thank you very much. You are very clear.

A - Unidentified Speaker

Thank you.

Operator

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

Q - Unidentified Participant

Good morning, everyone. We saw Bandeirante and Escelsa with good performance in terms of losses. What can we expect from now on. Are you going to be keeping at this level, you are having further actions to reduce that even further? What can we expect?

A - Unidentified Speaker

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Hello, Kayeek [ph] and good morning. Thanks for your question. We have been reinforcing our plans to fight the losses especially in a scenario of high tariff, that is even more necessary and important to see to this levels because this has a reflex on delinquency and losses. Our expectation is that Bandeirante can be very close to the regulatory target. As you know as of October 23rd we are going to have new tariff. We believe that we are going to have a bit less of a decrease. We believe that in the new curve, we are going to have a variation of 4.5 percentage point.

So it's going to be a little less cheap in terms of loss reduction and we believe that Bandeirante will continue to comply with regulatory levels. As for Escelsa, we are very much aware of the difference that we have compared to regulatory level. And as of August, we are at 7.9% more or less, so we still have a large gap compared to regulatory number. And we would say that in the end of the year, we should be about 15% losses. So, below 16 and we estimate that in the end of the year, we are going to get to approximately 15%. So the focus will continue to be to shorten this difference in regulatory losses. As we know, according to demands [ph] that are in effect for this tariff cycle review as of August 2016 itself, loss is going to have a review up. That is going to go from nine to eight. Our current estimate tell us from 11% to 12%. So these are the numbers that we expect. So, next year the regulatory target is going to go up as of August and we are going to go down, so that we can shorten this difference more and more. And as of 2016, it's going to be even shorter that we are going to continue with this work -- with our work. Thank you very much.

Operator

Our next question comes from Carolina Carneiro from Santander.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Good morning, everyone. I have a question about the sale of (inaudible) I would just like to understand if you have any other assets in your portfolio that you believe would be in the same scope of this asset. And therefore could also be put to sale or today after the sale your portfolio seems to go [ph] and you would be pleased with the assets that you have without the (inaudible) anything else.

A - Unidentified Speaker

Well, thanks for your question. This is a very interesting question because we still have a small hydropower plant in Mato Grosso do Sul called Costa Rica [ph]. We hold 51% and our intention is to do the same as we did with (inaudible) and sell this asset. So we are just opening the process to consider the sale of this asset. With that we would no longer have assets in Mato Grosso do Sul and we would be concentrating our assets, the hydroelectric assets in Espirito Santo (inaudible) Amapa and Para and the two plants that we are building now. So, we would no longer have any asset in Mato Grosso do Sul.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Okay, thank you very much. If you allow me, I just would like to have a follow-up and finish this question. Today, perhaps, you're not completely sure about what you will need in terms of hedge for next year and in the coming years for energy. You believe that parts of

this hedge you're going to take the market, what the price levels are you expecting? You talked about R\$200 or about R\$200 per cost prices. Do you believe the long-term prices are going to be back, what do you consider suitable, vis-a-vis with what we have in the market that's today?

A - Miguel Setas

Well thanks for your question. We have our Energy Director here and I'm going to turn the call to him.

A - Unidentified Speaker

So well thanks, Miguel. Carolina, for next year, it's important that if you say I have this option right now, we are working in the net negotiation with the government for us to have an agreement that will limit our risk and somehow also enables us to have good results for the year. We are still negotiating, but there are two good perspective for us to have a good agreement. As per the hedge, if we don't have the agreement in next year, we have to live with very high GSF. We are prepared then of decontracted energy.

If we do have negotiation, we are going to go to the market, the market is going to be high. Prices are going to be around R\$200 or R\$190, which is a good number. And I think that will help us in the mitigation of risk. And I think that's it.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Okay, thank you very much.

A - Unidentified Speaker

In the long-term, it will depend on what the solution is going to be in terms of new energy to rebalance the system. The system today is unbalanced. We need expansion, in the long-term, we believe that we are going to have a slightly lower balance. If projects are concluded in decent time, our prices are going to be a bit better. But we don't believe they are going to go in the next year below R\$150, R\$160.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Okay, thank you very much.

Operator

(Operator Instructions). Our next question comes from Paulo Ferreira from Bradesco.

Q - Paulo Ferreira {BIO 18941383 <GO>}

Good morning everyone. My question is also about the discussions you're having with the government for a possible solution for the GSF problem. I saw it on Monday that one of the proposals that were analyzed by the Ministry was the proposal of EDP. If you could give us some color about your main point in your proposal what you suggested and that the solution would be, the best solution for the generation industry? Thank you very much.

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A - Unidentified Speaker

Hi, Paulo, thanks for the question. We have, working together with (inaudible) and other companies in the industry, in negotiations with the government. And the proposals that are being shared today do not have much margin for maneuver.

We have a regulatory asset that is being built. We can discuss if 2015 is going to be part of that or not, this regulatory asset, despite the GSF level at this time. And this can be offset with an extension of the concession time or a transfer of cost to tariffs or a mix of both solutions and the extension of the concession and a partial increase in tariff. What the Ministry is saying, is that this hedge, this offset would have to have the commitments of companies to increase the physical guarantee of plant. Participation of auctions to increase the physical guarantee of company. We have been very impacted with regard to that. We are saying that the Brazilian system needs low cost thermal plant.

They are natural hedges of the hydroelectric power portfolio and they have a co-relation almost linear to the (inaudible) or the construction of margin in the hydropower plant. So, thermal plants have good result in terms of rationing of water level. And so, what we did is that, we proposed this thermal plant, the small thermal plant as a hedge to the system to increase the fiscal guarantee of the system. We believe that these are cheap plants that can be natural hedges for hydroelectric powers, so they have lower cost and they can have a mitigation of risk in the country. So that was basically the lines of our proposal, but we are following all the discussions with (inaudible) and we are sharing other solutions that are being discussed. So, our proposal is not the only proposal that is being discussed.

Q - Paulo Ferreira {BIO 18941383 <GO>}

Okay, thank you very much. If you allow me, I still have one more question. Do you think that the things are going to happen next week, are you going to have a solution or do you believe that the things are going to be postponed?

A - Unidentified Speaker

We still do not have a final decision on that. I believe that based on the evolution of our negotiation, there is a (inaudible) of this decision to be postponed. So we still do not have a clear idea on that.

Q - Paulo Ferreira {BIO 18941383 <GO>}

Okay, thank you very much.

Operator

(Operator Instructions). As there are no further questions EDP conference call to discuss the earnings of the second quarter 2015 is now closed. Questions received from the webcast are going to be later answered by the IR team. We thank you very much for joining us and wish you a good day. Thank you.

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