

Q3 2016 Earnings Call

Company Participants

- Carlos Márcio Ferreira, Vice President - Electric Power Distribution
- Maurício Perez Botelho, CFO & Director-Investor Relations
- Ricardo Perez Botelho, CEO & Vice Chairman & Deputy CEO

Other Participants

- Antonio Junqueira, Analyst
- Kaique Vasconcellos, Analyst
- Marcelo Britto, Analyst
- Maria Carolina Carneiro, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by and welcome to Energisa's Conference Call to discuss the third quarter of 2016 results. We would like to inform that during the company's presentation, all participants will be in the listen mode only. We will begin then the Q&A session when further instructions will be given. We also would like to inform that the conference will be made in Portuguese by the company's management, and the teleconference in English will have simultaneous translation.

Before we continue, we'd like to clarify that any declarations that maybe made during the teleconference have to do with the company's business and also goals are assumptions, and beliefs of the board, based on information currently available to the company. Future considerations are not guarantee of performance; involve risks, uncertainties, and assumptions; and, also refer to future events and, therefore, depend on circumstances that may or may not occur.

Investors should understand that general economic conditions, industry conditions, and other operational factors may affect the future results of the company and may lead to results that will differ materially from those expressed in these beliefs.

Now, I would like to pass the conference over to Mr. Maurício Botelho and he will begin the conference. Mr. Maurício, you may proceed.

Maurício Perez Botelho

Thank you very much. Good afternoon. I would like to thank you all for your presence in our earnings call for Q3 2016. We have in the call Ricardo Botelho, also Cláudio; Carlos Márcio Ferreira - Alexandre Nogueira, Director for Regulation; Carlos Márcio Ferreira, Vice President of Distribution; and, Mariana Rocha, Investor Relations Officers.

So, I'd like to talk about the results and then we will go on to the Q&A session.

Let's begin on slide number 3, please. The first thing I'd like to highlight, the market performance. We have a drop of 1.5% in Q3, 1.3% year-to-date. This has to do with the increases and we have had many things affecting the sales.

And finally, climate factors. We had a drought. And this, we had in the Midwest. Also as a consequence of this scenario, we observed an increase in total losses and we will analyze this later.

The financial highlights. I'd like to stress the drop of operational expenses, reduction of 1.3% with an inflation of 10%. Additionally, I'd like to say that we have also, PMSO reduced by 1.3% and net debt as of September 2016 amounted to BRL 5.855 billion.

In Q3, we had BRL 87 million in CVA and here, we amortized BRL 16 million.

Concerning also the shares, in August, we issued net debt, and it went from BRL 7 billion to a little over BRL 5.8 billion. Investments grew 15.9% in Q3 2016, reaching BRL 380 million - BRL 509 million, of which BRL 380 million was made in electricity assets.

Among other events that occurred, we would like to stress the conclusion of Rede's Bankruptcy. Almost three years after the purchase of the assets, all the obligations were made, and we also - it left bankruptcy recovery.

And another point I'd like to mention, the distribution companies. We have four companies in São Paulo, one in Paraná. And I'd like to explain why Caiuá had this loss, BRL 75 million. And after the rationalization, there's an expectation of a merger in 2017. We hope to have merger of the unit in Minas Gerais.

Now the next slide, number 4. Here we have data about the market. On the graph on the left, we have the variation between quarters. As mentioned, 1.5% drop. And if we look at the variation, number of days, we have the drop in consumption in the captive market, free-captive market, 2.8% in the quarter.

On the graph on the right, we have the variation of consumption by class, represented by residential, with EBITDA margin where we have the largest market share, 34% in total. It had a growth in the quarter 2.2%, end of the year 3.2%. And we had growth in Tocantins and also Paraíba, 5.6%.

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Now, the second segment that grew: rural. We can see here, and also due to exporting of agricultural commodities in Mato Grosso. On the other hand, we had a drop in industry, 8.4%, of which 5.8% can be explained by a drop in Minas Gerais, 22%, due to a problem in a very large client that we have in this area. In Paraíba, a drop of 14.2% due to a drop in consumption in the textile industry, and Energisa Mato Grosso, 7.4%, thanks to a slowdown in industry. In Tocantins 16.8% drop as we have in an area there. We - there was a drought in the states reducing the production of food. The commercial class, there was a reduction in a company at the Midwest.

In the graph below, we have consumption year-to-date, a drop of 1.3%. We noticed an expressive increase in the north region because of concessions and we see here south/southeast with a negative number.

On the next slide, slide number 5, we see total losses of the group. On the graph on the left, we have the division between technical losses and non-technical losses. And here, we see 12.53% of the energy produced. We see here the difference in relation to 2015. We have made efforts to fight losses in Mato Grosso and Tocantins.

In the case of Mato Grosso, we increased the teams, also another 18 teams, to fight losses. We hope to go back to previous levels in 2017. In Tocantins, we have some measures to improve the performance. We have the losses, here, in gigawatts in the quarter and we hope to improve this by the end of next year.

Now, we have here our goals for Q4. If we consider this, we have an increase in the percentage in Minas Gerais, Bragantina, Midwest. As you can see, Caiuá in the forward cycle, 7.7%; and, Nacional, 8.2%; Bragantina, 4.9% to 5.2%; Minas Gerais goes up; and, here, the last one 5.8%; the next, from 3.8% to 4.2%; Tocantins, 3.9%.

On slide number 6, we have DEC and FEC. Concerning DEC, all the distribution companies are in this situation with the exception of Tocantins. Also, FEC, in our area, in - it is - we have, here, lower levels. Some distribution companies have better quality indicators. These are the companies located in the Northeast in Mato Grosso. In the case of Tocantins, Tocantins, we had the lowest level of DEC in that company.

Now, those who want regulatory effect, we have continuous improvement not only a reduction in the payment of fines and penalties, but also increasing the well-being of consumers. So energy is second in terms of quality services. Apart from this, finally, we have a good satisfaction index in Tocantins in the North, Energisa Borborema, also Paraíba in the Northeast, and Mato Grosso do Sul here.

Going on to slide number 7, let's talk about financial details in the quarter. Analyzing personnel, material, services, and other, the graph on the left, we have BRL 30 million extra higher expenses. We had collective agreements, labor agreements, indemnities, and strategy to internalize some activities that were outsourced. So this internalization presented a reduction in the year-to-date, BRL 25 million. And thus, in the end, a reduction of minus 9% in comparison with 2015.

The graph on the right, we have the PMSO, and we have a greater negative number. These results show the cost management and our actions to reduce expenses. They will be concentrated on reducing expense.

Slide number 8, here, we have a graph that explains the evolution of consolidated EBITDA in the quarter. In the first graph, we have an increase of 26.5%, adjusted EBITDA Q3 2016, and also compared to 2015. Here, we have - we're in a negotiation for past due amounts; in Mato Grosso, BRL 86 million. Although, here we know that this debt is considered at present value, and it was recorded (15:25-15:30). Now, just considering these effects, BRL 86.6 million, 6.2%.

Also for indemnities, we would have BRL 494 million, 8.7% higher than the one in Q3 2015. Also on this slide, I would like to make additional comments concerning the payment in arrears. We have financial revenue, BRL 40.5 million, which - and it's a reclassification.

On slide number 9, here, we have analysis of EBITDA of Rede Energia. Quarter compared with quarter, a growth of 68.4%. So, similar to the previous slide on the graph on the right, we have adjusted EBITDA excluding non-recurring effects. So we have an increase in EBITDA of 34.3%.

On slide number 10, we have - we reversed some BRL 133 million and a net profit of BRL 63 million in Q3 2016, a variation of BRL 196 million. So, apart from reversing, in Q3 last year, we had the effect of swaps. Now, currently, everything has been converted to CDI. Now, here, we explain the non-recurring effects. Here, we have BRL 28.4 million, and we have a positive EBITDA, BRL 39 million.

On slide 11, talking about the indebtedness of the group, the debt. We had an IPO in August, BRL 1.5 billion. And thus a reduction in net debt, BRL 5.856 billion. So the debt dropped. And here, we can see the number, and now, 3.2 times. Also, this allowed us to have an increase of BRL 680 million to increase capital, modernizing and - substations and also the distribution of electricity.

Here, we had these capital increases in October and November. And in Rede Energia, we had 96.8% (sic) [96.2%]. Mato Grosso, participation went from 58.8% to 66.6%, Energisa's total stake; Tocantins, 71.4% to 76.7%, with a capital increase; in Bragantina, 91.6% to 95.8%. Also, we capitalized Energisa Minas Gerais, Nova Friburgo, and Caiuá. Within these companies, we already had 100% of the capital.

Now, talking about debt and leverage, here, we have the amortization schedule. As you can see, we have a comfortable cash position, more than 2 times the amount we - 2.1 times what we need for amortization in the next 12 months.

Here, 61% (sic) [55.7%] of the debts are linked to the CDI index. So a reduction of 1% in the interest rate will represent an improvement of BRL 56 million less in interest cost per year. Our rating was upgraded to AA, went from A minus to AA, and Sergipe also went to AA plus.

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On slide number 13, we have the investment, total investments, 77% in assets (21:34) BRL 947 million. Energisa Mato Grosso, the one that invested the most, BRL 500 million, and here, Tocantins, BRL 227 million; Energisa Mato Grosso, BRL 176 million. In general, the investments are concentrated and expanding capacity and fighting losses and improving quality. We see an increased investment in special operations and also satisfaction when we see the improvement when we compare with 2015.

On slide number 14, here, regulatory. Here on the graph, we have the percentage of RAB changes between third and fourth cycles. Here, we see the correction made. You can see that Tocantins is at the top of the ranking and also good results in São Paulo and also Bragantina, 20%, and then Paranapanema with 14% and 10% here, as we can see. And Minas Gerais and Nova Friburgo, although lower, they're still positive.

On slide 15, we compare regulatory EBITDA versus adjusted reported EBITDA. The actual EBITDA reported in the consolidated. We are 20% better than regulatory EBITDA due to an efficient expense management at the distribution companies. In the case of the pioneers, 49% above regulatory EBITDA. And in the case of the acquisitions, although some are in progress, we're also better than the regulatory level.

In this way, we'd like to end our comments, and we'd like to begin the Q&A session.

Q&A

Operator

Thank you. We'd like to begin now the Q&A session. Mr. Kaique Vasconcellos from Citibank would like to ask a question.

Q - Kaique Vasconcellos {BIO 17317373 <GO>}

Thank you for the call. You were able to reverse some amounts. Can I ask you, are there more opportunities in this area? What can we expect in the next quarters?

And if you allow me a second question, we found that leverage after the ideal 3.2 net debt per EBITDA. Okay, we see the possibility of a drop. So what is the company's appetite for new assets and how do you see competition for new assets in the sector.

(25:47-25:54)

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

I'd like to comment on the appetite for new assets. Good afternoon. We are always evaluating the opportunities that come up and we have the IPO. We're very focused on really getting the results in the assets we acquired since 2014.

We also have a continuous evaluation of opportunities. I would like to say that we have been looking at the opportunities. We're talking here of analysis on two occasions and

(27:06-27:10) we're always looking for assets that are in our distribution market. So we have nothing concrete, but we will continue evaluating.

Concerning market opportunities, in spite of the organic growth, we are always looking for things that can add value in a cautious way, in a prudent way. And this, we're looking at privatization opportunities, and we're looking at opportunities where we can use our know-how and the opportunities that are adequate for purchase.

(28:19-28:23)

Concerning reversal of accruals, we always have cases with city halls that have debts in. We have this case that - where we were negotiating for many years. We don't have any other large cases to reverse accruals.

Q - Kaique Vasconcellos {BIO 17317373 <GO>}

Thank you.

Operator

Mrs. Carolina Carneiro from Santander has a question.

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

Good afternoon. Thank you for the call. Two questions. The first has to do with losses. You mentioned that you have an action plan to focus on losses. Correct me if I'm wrong. You mentioned that in the case of Tocantins, you want to reach the goal in 2017. Could you give us details about the measures and the impact on CapEx. What is the investment to be able to reach this goal, and also effects, too? And the second question concerning costs. The performance was very good. We want to know if the parts that have less regulatory penalties, fines, have you reached the level that you believe is adequate? Or is there a space to reduce expenses even more on this line?

A - Maurício Perez Botelho

Well, I will divide the answer. Carlos, you can talk about the losses.

A - Carlos Márcio Ferreira {BIO 15944970 <GO>}

Concerning expenses, as mentioned by Maurício, in Mato Grosso and Tocantins, we are above regulatory. In Mato Grosso, we are taking measures increasing the size of the teams and the number of teams to fight losses. There is a concentration in that region between Cuiabá and Várzea Grande where they're increasing the teams by 30% to fight losses.

In Tocantins, the increase we had has to do with administrative losses. We have made the decision and we're working on the reading increasing the teams in order to really bring these administrative losses to an acceptable level. So you have these values. They have an impact on CapEx and OpEx, 70/30, 70% CapEx, 30% OpEx.

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

Thank you.

A - Maurício Perez Botelho

Well, concerning the other question, regulatory penalties, we are evolving, we're investing. We are - we have actions until 2017 according to our agreement with ANEEL, the regulating agency. And considering here the OpEx and CapEx, reminding you that in the case of Mato Grosso, the state of Mato Grosso, the regulating agency established that we have to work during a period and we have special obligations. We have to invest in assets. If we have failure in Mato Grosso, I don't believe this will happen. We would have the fines (33:49) being - the value of the price being doubled or even tripled. I don't believe this will happen.

Operator

Mr. Marcelo Britto from Citibank has a question.

Q - Marcelo Britto {BIO 15393330 <GO>}

Maurício, good afternoon. I have two questions. The first has to do with your initiative to have a shared service center. So please tell us, what is the state of the implementation and the benefits that you expect, tax credits, because of this structure? That's the first question.

The second has to do with comments, please comment on whether you're considering to participate in the auction at the end of this month. How was competition? And if you have a minimum price for the sale of this company?

A - Maurício Perez Botelho

Well, Maurício (sic) [Marcelo], concerning CFC, we're in an implementation phase. It should be ready in 2017, the shared service center. The benefits - the tax benefits who come from the tax credits that the holding has. The holding company will render services. We have tax credits.

Now, concerning the auction, Ricardo, would you like to answer?

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

We cannot comment on our participation. It hasn't been defined yet. We have to - I know, it's at the end of the month, but we don't have a final decision about the participation in the auction. This is the only answer I can give you right now.

Q - Marcelo Britto {BIO 15393330 <GO>}

Thank you.

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Operator

Mr. Antonio Junqueira from Pactual would like to ask a question.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Good afternoon. It's a simple question. Give us more details about the performance of EBITDA, of Energisa, of the state of Sergipe, although it has a good OpEx behavior. And please talk about MS, EMS. It has very volatile EBITDA, and especially in this quarter, volatility went down.

Give us more details about these operations. Both had good OpEx. Both had losses within the expected levels. Volume was not very serious. So it's hard to understand where this difference comes from in EBITDA.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

Maurício?

A - Maurício Perez Botelho

These two have suffered a lot in terms of markets, and, yes, there was a drop affecting the performance of these two.

In the case of Mato Grosso do Sul, we had a climate effect. That quarter was very cold, cold weather, and thus the volume fell. It is an abnormal effect in this regions, cold weather.

In the case of Sergipe, we have here an issue of a reclassification of the CVA. We had monetary correction, and we had some effect on some financial components. So therefore, we had this variation. It's only a reclassification without affecting results. (38:50-38:56) So apart from reclassification, you have the mix and demands. The mix - the mix, especially in the state of Mato Grosso - Mato Grosso do Sul.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Thank you.

A - Maurício Perez Botelho

We have a question from webcast. Mr. Tiago (39:05) would like to ask, could you comment on expectations of PMSO expenses for next year, 2017?

A - Operator

I believe it's difficult to give you a guidance performance in terms of expenses. But we believe that we're reducing expenses. Investments are being made in automation, mechanization. And this should really improve our expenses, lower our expenses, especially in the companies that we acquired.

(40:06-40:14)

Thank you. The Q&A session is ended. I'd like to pass the floor to Mr. Maurício for his final comments.

A - Maurício Perez Botelho

Well, we'd like to thank you all for your presence. I would like to highlight that we continue working very hard to improve operations in the companies that we acquired. And we see the continuous improvement in the distribution companies. Here, in Q3 2016, we have an improvement in quality and also cost reduction. We (41:02-41:09) not all the regions are suffering from a very severe recession, the longest and most difficult one we ever had, and - but we're seeing a recovery, especially in the industrial sector. And the industrial sector has surplus capacity. So with the recovery of the economy, we hope to have better results in the next quarters with the market recovery. So, thank you very much and a good afternoon.

Operator

Thank you. The teleconference of Energisa is now ended. Please disconnect and have a good day.

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