

Q3 2016 Earnings Call

Company Participants

- Eduardo Antonio Gori Sattamini, Chief Executive, Financial and Investor Relations Officer

Other Participants

- Andre Sampaio, Analyst
- Caique Vasconcelos, Analyst
- Ezequiel Fernandez, Analyst
- Vinicius Canheu, Analyst

Presentation

Operator

Good morning. This is ENGIE's Conference Call where we will discuss the results for the Third Quarter of 2016. All participants are connected only as listeners and ensuing this, we will open up the question-and-answer session when further instructions will be given for participation. (Operator Instructions) We would like to remind you that this conference call is being recorded.

This presentation followed by slides will be simultaneously transmitted through the Internet through the site, www.engieenergia.com.br at the Investors section. A slide presentation and the company's earnings release are also available on that website.

Before proceeding, I would like to clarify that all statements that may be made during this conference call regarding the business outlook of the company should be treated as forecast as they depend on the country's macroeconomic conditions on the performance and the regulation of the electric sector besides other variables, therefore they are subject to changes.

With us today we have Mr. Eduardo Sattamini, ENGIE's Chief Executive Officer and Financial and Investor Relations Director and Mr. Rafael Bosio, Investor Relations Manager. Both will speak about the performance of ENGIE Brasil for the third quarter of 2016. And we'll offer you an update on the development of the Jirau hydropower plant. Immediately thereafter, we will go on to questions and answers.

I would now like to give the call over to Mr. Sattamini. Mr. Sattamini, you may proceed.

Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

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Good day to all of you. I would like to thank you once again for your presence at this call. I now have become the Chief Executive Officer as of January, I will focus fully on the work as a CEO and we have hired Carlos Freitas. During the last three years, he has been working with us, he knows the company quite in depth. He has been with us almost 16 years or 17 years. And he will come to contribute a great deal to this company. It is a pleasure, therefore to have Carlos Freitas with us and I will be able to focus on the more strategic issues, but evidently, we will continue to be very concerned with our shareholders.

Let us go on to slide number four that refers to our main financial and operational indexes with quarterly comparisons, and once again, with short-term results.

We always warn you once again that these are the immediate and short-term results and we're quite confident in the results of this company. To speak about our net revenue, we had a minor drop, especially due to the short-term operation. We had an increase in the price in the market during the second market below inflation, which is a natural situation. Last year, we had contracts with extremely steep prices and due to the high prices of 2014 and 2015, we (inaudible) with these very high prices. And therefore, the value of these contracts were contaminated by these exceedingly high prices as inheritance from 2014, 2015. So, we had a small reduction of 2.3% in revenues.

In terms of results from operations, a small improvement, 4.9% for this quarter with a better improvement when we compare the accrued figure for the year 10.8%. And this refers mostly to the cost of energy sold. We will also observe a drop further ahead.

EBITDA, 4.6% above for this quarter and 9.5% for the nine-months of the year. Because of this, our margins have increased from 47% to 50.4% for the quarter with an increase of 14.2% compared to the third quarter '15 and 19.0% with 1,072.7 million for '16. I think our financial results were quite relevant, our cash position very relevant.

We had a reversion compared to last year, once again, because of the high interest rates and the projects that are underway. We also have the BNDES funding that was clearly released. And the rates were quite stable during the beginning of this year. The situation seems to becoming more normal. We no longer have to retain our cash and we should go back to slightly lower levels.

We had a reduction in net debt because of our better thermal generation. We have thermoelectric dispatches that are lower, much lower because of the activity of our plans, 7.3% which is relevant. And the production of energy therefore is not going to necessarily impact the profitability of the company. We have already spoken about the sales price with an increase of 4.9% from quarter-to-quarter and 5.6% from one year to the other.

The prices in 2015 once again were very high due to the short-term contract and continued very steep. In terms of the number of employees, you will perceive a reduction in our headcount, especially because of the new plants that we have in place. It is a plan for voluntary retirement. We had a group of people that left in April of 2016 and we will

have a second group of people leading in November allowing us once again to make an adjustment in the number of employees for the year 2016.

As you will see, we're beginning to gain more body, but we will still have to have a few new hires to be able to face up to our new projects. And we're going to carefully separate our permanent employees in the company from those that are temporary, and that are brought in temporarily while our projects are underway.

Let us go on to slide number five, continuing with the highlights, the first highlight is that the wind farm in the Santa Monica Wind Complex entered into operations on a test basis the previous semester and this is fully operational at present.

Once again, the commercial operations began in October of this year. A bit further ahead, we're going to refer to the project as a whole and what is happening to the several units that are part of this complex.

We received an award from Expressao de Ecologia because of our photovoltaic projects, which is a project close to one of our plants. And once again, this is the greatest photovoltaic plant in Brazil, which make us -- there is no other larger in the country and we were awarded, thanks to the sustainable development of this photovoltaics solar energy plant.

We go on to slide number six to speak about the approval of credit as interest on shareholders' equity. The amount was substantially higher vis-a-vis 2015 where we appropriated 340 million, this year we have reached the amount of 432.5 million, perhaps mainly due to TGLP [ph] that was higher than last year. And once again, reversion of cash that also increased, thanks to the calculation base for shareholders' equity. So, the increase was up approximately 30% we have in this case.

We have already mentioned the appointment of Carlos Freitas as the company's Chief Financial Officer. Another important information at international level, we have inaugurated a generation's operation center, which is installed in the head office in Florianopolis and we have begun our remote operations. It is one of our big projects and gradually we would like to bring all of the operation of the plants into our head office.

This will give us greater operational efficiency, maintaining a minimum headcount at the plant and gaining scale in our operation. We will have three plants this year, another three plants that will work with this remote operation. And the intention is eventually to have all of our plants being operated remotely. This means that we will no longer need a full headcount for operations at each different plant. The intention is that the centralized operation will give us important synergies.

In slide number seven, the shareholding structure, once again we do not have any great changes except for the fact that ENGIE Brasil distributed energy. And we mentioned this at the last meeting, we have acquired Geracao Distribuida, a company that works with residential solar panels and industrial purposes as well. And it is our understanding that this will have significant growth in the coming years.

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On slide number eight, we will see the diversified portfolio. We have the Santa Monica Wind Complex that came into operations in October. And we had, if I'm not mistaken 7,009 megawatt the last semester, which is given to us by the Santa Monica Complex. We have 7,027 megawatts installed. This also changes the complementary energy installed as part of our energy mix, 79 for hydro, 6% for complementary and 50% for thermal.

On slide number nine, we continue as a Group to be the largest independent power producer in the country as ENGIE Brasil Energia. This is in the hands of ENGIE Brasil Participacoes and we have a new competitor that is CTG, which has been having significant growth, but they're still not very relevant. Our intention is not to be the largest, but yes, it could be the most efficient and the most creative, the one that creates and captures the best business opportunities.

We go on to slide number 10, speaking about our portfolio once again, we have a well balanced portfolio among distribution, free customers and trading companies. This coming year, we have a contract that is maturing in 2016, the energy has already been contracted and you will see this in our energy balance further ahead.

Now, the idea is to also work in the regulated market to maintain the stability of the company. We're extremely careful with our markets, the risk diversification is important. We want to ensure that we protect the quality of our credit and you will see that we do have broad diversification in several sectors of the economy.

We also have policies not to go beyond specific percentages with some companies, but we are faced with some moments where some segments require additional caution and we make sure to have lower volatility and we decide to hold back in Energia [ph] contracts.

Now when there is a crisis, crisis tends to affect the general demand. And we have 2,052 megawatt average contracted and this semester we have 1,991 average megawatt, once again, because of the flexibility that we have with the contracts. And this will not necessarily repeat itself in 2017 if there is a recovery, it is doubtless that our clients will go back to contracting energy.

In slide number 13, we speak about the revision of demand. We have had to carry out a revision of demand of 2 gigas or 2.1 gigas were reviewed for 2016 and for 2017 and 2018, 2019 considered as an increase in demand as the company begin to adhere to the new law of clean energy and they are having difficulties in implementing their projects. When the grants begin to get cancelled, this should also have an impact on the future expectations of the granting of energy and we will see, which will be the impact of this in the coming years.

To the right, we have the distribution of supply by source. We are still faced with that situation where we have the supply and demand of thermal electric plants and which leads to a greater volatility in prices as well during the year. We have higher prices, lower prices and the fluctuations that you can observe, this is evidently what we're facing this

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year. We have had an exacerbation in the part of hydrology beginning in April and May extending up to present, which is also impacting generation scaling factor.

On page 15, we speak about our commercial strategy with comparisons year-after-year looking towards the future. We have a balanced contract portfolio, that will have a great impact, we also have large un-contracted energy in a very timely fashion. But as you can see, we have stable results. You can see that we are quite contracted for the next three or four years, we are going release or have more energy beginning in 2020. Once again, due to this characteristic, each contracts are for four years and certain years, we have a higher volume of energy contracted. We also have un-contracted energy, we have our portfolio for 2016, 2017 and 2018 to guarantee a certain comfort taking into account the market opportunities. Now for 2019, 2020 and 2021, we will have a reasonable un-contracted energy in our portfolio and we can see this quarter-after-quarter. In the third quarter of 2019, we will have 90 megawatt of energy, and for 2020, 60 and then a 114.

In slide number 16, we're presenting to you our energy balance this or that analysts that can look up on all of our contracts and the amount included in each of these contracts. Evidently, I'm not going to go through this information in detail.

We go on to slide number 18, we're going to speak about the Jirau project. We have 45 units already installed out of a total of 50. We have three plants that are already generating and an additional two plants with turbines that are under commissioning, which means that we are now in the final stages of construction. At the end of the year, all of the turbines will come into operation and it is very possible that the transfer of assets will begin at that time.

We're going to see with the Controller [ph] when will be the most appropriate moment. The risk is quite significant, the construction risk will be mitigated until the end of the year and it is very possible that the Controller will define the structure to transfer this asset and this will be brought to the Board of Management of ENGIE Brasil Energia, so that the Board of Management can carry out its evaluation and study with the Controller.

On slide number 19 and 20, you'll see some pictures to the right, the right bank that is completely constructed, to the left a powerhouse that is still being assembled. One is a picture from September, the one to the right, a picture of October, which is of course more updated.

Page number 21, the Pampa Sul project, a thermal project where we're beginning to assemble the structure as you can observe in the picture. We have had some difficulties in this assembly, but of course, these are natural obstacles in what is a complex project.

We go onto the Campo Largo Wind Complex. This is a complex that will come into operation in 2019. We're going to install the work site and we will have a great deal, more movement beginning in 2017. This Santa Monica project already has a generator that has gone into commercial operation. In truth, we have three generators that are under operation. And the idea is at the end of 2016 or 2017, begin to have a full commercial operation and therefore, this will no longer be a project, it will go into operation.

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In slide number 24, we have a project that is at the very beginning -- the beginning of operations here. It's only for 2018, it is the Assu Photovoltaic Central. We are beginning to structure the funding for this Photovoltaic Central and we should be taking some steps towards installing the work site.

In page number 25, a project that is under development for distributed solar generation project that ended up being much larger than we expected. We have entered the commercial market. We already have some installation contracts that are of a greater magnitude for commercial projects and this is a market that we're betting up on heavily.

When it comes to our projects under development, we still have the other phases of the Assu project that will be our future business. We have an auction in 2016, we have Santo Agostinho, Campo Largo, Alvorada Photovoltaic Complex, but we -- well, we are not going to have anything happening there, but we will have some new projects in transmission areas that will not have an impact on the project. Once again, none of these are big projects for 2016-'17.

On page 28, we show you our main financial indicators, net revenue, EBITDA and net income. These are difficult moments and we have been able to maintain a stable cash generation and net income. And this is the important message here on page 28.

On page 29, we speak about the net revenues from sales change comparison from quarter-on-quarter. We had an increase of 26%, but we had a reduction in volume leaving us to be negative 35% and in the short-term, a good revenue that went to 29 million this year and an impact on the short-term market availability. The GSF this semester must be of approximately 83.

It was not informed in the month of September, but what is important is that risk premium, now that has led to some benefits during the quarter. In terms of risk, we paid BRL6.6 million and we had a loss of BRL34.7 million. We did not expect to use the GSF, but we did end up using it in 2016 and it has been effective and has helped us to stabilize our results in the regulated market.

On slide number 30, the changes in EBITDA, we had a reduction of 71 million, in the net income, an increase of 41. This has also contributed to the EBITDA. We had less expenses with fuel, less thermal dispatch, especially with gas. As you recall, coal has a reimbursement and in the short-term, 6 million less, which is a difference of 99 million that we had in 2015 compared to 1 million negative that we had because of the results of the Electrical Energy Trade Board. So the increases you can see here in EBITDA was 4.6%.

We go on to the net income change, our financial results contributing with 41 million, 27% more in revenues, 36% less in expenses, a rather low percentage. And therefore, the financial expenses have had a drop and our balance in this case was positive. In the previous slides, 35 million from EBITDA, a depreciation that was somewhat greater compared to the last quarter because of the maintenance and this maintenance will continue in future years' income taxes with a better result.

And from the third quarter of 2015 to the third quarter of 2016, an improvement of 14.2%. Our debt, which is very limited, we have no currency exposure. Once again, our debt is fully covered by hedge instruments. And our net indebtedness falling from 4.2 to 2.2 of the EBITDA.

Now when we compare the total debt and EBITDA, were approximately at the same level 2.2. When we compare the total that we have a small drop to 0.70%, once again, it's a comparison from quarter-on-quarter and some quarters were doing better, other quarters less. And this is how we do our comparison. Cash were 3.85 million, cash-on-cash equivalents, which is a significant operation of 2.34 million.

And in October, we paid dividends, more than BRL300 million in dividends and the debt for the quarter fell from 1,213 to 700 and some, a drop of BRL448,000. The idea is that the debt will increase because of all the projects that we have underway, we're going to have to hire more debt. And eventually, perhaps we will have to pay off part of this debt, this still has not been defined. Therefore, we do have a room to work with these definitions, perhaps work with the greater leveraging without putting at risk the company rating.

On slide number 33, the net debt change were the investments and cash generation, operational activities and I would like to mention the reduction in working capital. If we compare quarter-on-quarter, you will see our better cash position.

We go onto slide number 34, once again, speaking about the medium and long-term debt, we have 832 million that will be mitigated. We only lose because of the exchange variation projects that we contracted in 2014, and because of the difficulties that we underwent in 2015 with the extremely complex economic situation. As you are all familiar with, in 2017, the normal amortizations of our long-term debt and the graph shows you a higher value. This is because it includes a total of five years. The composition of the debt, as you can see, we do have a part that needs to be amortized. And this is due to the debt that was issued in 2015 going on to 2016. Once again, (inaudible) to the funding to modernize our assets and there is a cost of fixed small size operations.

On slide 35, our CapEx appropriation. You have seen the large number of projects that we have for 2016, 2017, some are in the conclusion phase and we have several million that was retained that will be used, of course, in the stages of the Jirau project. Once again, we still have not defined how we're going to use this.

Our dividend policy, we continue to pay 55%, we believe that because of all of the enterprises that we have underway, we will have the possibility to continue to pay out these amounts of net income.

Ladies and gentlemen, once again, this is the presentation. We are now very happy -- we will be very happy to entertain your questions.

Questions And Answers

Operator

Thank you. Ladies and gentlemen, we will now go on to the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Caique Vasconcelos from Citibank. Mr. Vasconcelos, you may proceed.

Q - Caique Vasconcelos

Good morning to all of you. Thank you for allowing my question. A question referring to your energy balance, the average purchasing cost for 2016-2017 has had a drop. I would like to understand the reasoning of this change, is it because of your contracts or negotiations? Thank you.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

Thank you, Caique, for the question. I did not comment specifically on this, but the main factor was not the ones you mentioned, the main factor was the estimation of the IGM [ph] that ended up being lower, and therefore, we had to change our entire volume. Once again, we have not perceived this previously and it's the IGPM that is in our contract.

Q - Caique Vasconcelos

Thank you.

Operator

Our next question comes from Mr. Vinicius Canheu from Credit Suisse. You may proceed, sir.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Good morning, Mr. Sattamini. And another question, taking advantage of the first question, you are referring to the IGPM, but in your table, you always show us the current prices, what is your expectation for inflation going forward?

Now, my question per se, in this quarter, we saw that Duke [ph] is selling its assets in Brazil. You have been interested in this asset for some time. What drew the attention of the market was the valuation that was very attractive. On your part, I would like to hear some comments why you did not participate, which was the reason for which you were not interested in this asset, Duke? Thank you.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

I believe that I have already responded to this last quarter. When it comes to Duke, it is -- well, they have a concession until 2029, we have part of our excess debt in 2028 and because of this we didn't want to create a concentration of investment in concessions in 2029. That is one of the reasons why we didn't participate. Your first question that refers to prices, Rafael will respond to this.

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And once again we are referring to the general average price index, the energy balance has a better projection in terms of volumes and prices, and this is something that we assess every quarter in terms of prices and volumes. And this is how we come up with our price for the year. The way in which this is calculated, we have an assumption for the general average price index and then we work with the discount rate. What happened this quarter is that there was an adjustment going downwards, but the rest was unaltered and this ended up having an impact on the average prices for purchase and for sales.

Now, if you look at the trading only, there was a much greater drop in the purchasing price compared to the sales price.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Okay, that is very clear. We had understood that you were working with current prices and I didn't think that you included the general average price index and discount?

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

We do not update this every quarter because as I have mentioned formerly and reiterated, this was important years ago, includes our questions geared to other things. And the price issue here, well, we do not signal, we try the prices of the competition, we try to convey to you as much information as we have without having to signal all the price of our contract and this is the idea. Thank you.

Operator

(Operator Instructions) Our next question comes from Mr. Andre Sampaio from Banco Santander. Mr. Sampaio, you may proceed.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good morning. I would like to hear a bit about the possible changes in 2017-2018, changes in our methodology.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

The market was expecting a somewhat more radical change when it comes to risk appropriation. And because of this, the expectations for 2017 has a drop. The expectation is to have prices that are higher than the ones that we have exercised in the third quarter and that we will exercise in the fourth quarter. In general, this is our expectation. Now for 2018, this will depend on what happens in 2017. You will see that currently, we already have a very clear vision that enables us to be somewhat more precise in the amounts of the value.

Q - Andre Sampaio {BIO 19422379 <GO>}

Thank you.

Operator

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Our next question is from Mr. Ezequiel Fernandez from Scotiabank. Mr. Fernandez, you may proceed.

Q - Ezequiel Fernandez {BIO 17243886 <GO>}

Good morning, thank you for your call. First of all, I would like to ask about your level of contracting. We can see that you increased the contracts for the year 2021, I would like to hear your remarks on that. And I have a question on the pricing in the free market as well.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

The level of contracts that we increased in 2020-2021, yes. Our normal activity is to sell and decrease our exposure year-after-year and quarter-on-quarter for the years in which we have energy available. The trend will be to reduce the amount of uncontracted energy, this is natural. And in future years, once again the intention is to have a better sales flow, better service to clients and the maturity of contracts spread out throughout many years. This is a way of protecting price volatility quarter-on-quarter due to short-term influences or due to the close or a recession in the economy, this is a very natural position.

Your second question refers to the free market. We have had expectations for eventual changes and calculations and because of this, there has been a certain volatility. In the past quarter, the prices were 135, they went up 175. Once again, I'm referring to '17 and now the below 160 again. So what we have observed is a certain price volatility due to the application of new methodologies to calculate price due to economic factors. Beginning in 2018-2019, we have enormous doubts in terms of the behavior of the economy. And then the prices will tend to be higher, but they are not very far from the prices that we're considering for 2017.

As in previous years, we have not seen that the following year will increase to 200 or 180. What we see are more stable price level for the coming four to five years and with a marginal prices for expansion.

Q - Ezequiel Fernandez {BIO 17243886 <GO>}

Okay. Thank you very much for your very clear answer.

Operator

(Operator Instructions) At this point, we would like to end our question-and-answer session. I will give the floor to Mr. Eduardo Sattamini for his closing remarks. Mr. Sattamini, you may proceed.

A - Eduardo Antonio Gori Sattamini {BIO 16648085 <GO>}

I would once again like to thank all of you for your participation. Thank you for your questions. And still [ph] my expectation for the improvement in the macroeconomic situation, we have observed a great deal of professionalism in the government theme, the Mines and Energy Ministry, others that have granted a great deal of stability to the

market. We're rather optimistic when it comes to the behavior of the government and the necessary adjustments so that this sector can become ever more stable in the short and medium-term. This is the message I would like to convey to you, a message of optimism.

Operator

Thank you very much. The ENGIE Brasil Energia conference call ends here. We would like to thank all of you for your participation. Have a good afternoon and thank you all for using Voitel.

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