

Q3 2018 Earnings Call

Company Participants

- Alexandre Nogueira, Finance Director
- Claudio Brandao, Corporate Finance;
- Mauricio Perez Botelho, Investor Relations Officer
- Ricardo Botelho, Vice Chairman or Chief Executive Officer

Other Participants

- Carolina Carneiro, Analyst
- Marcelo Sa, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by and welcome to Energisa Conference Call to discuss the Third Quarter of 2018 Results. we would like to inform that during the company's presentation, all participants will only be able to listen to the call. We will then begin the Q&A session, when further instructions will be given.
(Operator Instructions)

We also would like to inform that the conference call in Portuguese will be presented by the company's management and for the English conference, there will be simultaneous translation. This event is also being broadcast simultaneously on the Internet via webcast, which can be accessed on the company's IR website www.seca.com.br/ri and MZiQ platform together with the respective presentation. This conference call contains forward-looking statements that are subject to known and unknown risks and uncertainties that could cause the company's actual results to differ materially from those in the forward-looking statements. Such statements speak only as the, on the date they are made and the company is under no obligation to update them in light of the new information for future development.

I will now turn the conference over to Mr. Mauricio Botelho. Please Mr. Mauricio. Botelho, You may proceed.

Mauricio Perez Botelho {BIO 2105889 <GO>}

Thank you. Good afternoon, everyone and thank you for taking part in our third quarter 2018 conference call. Here with me, I have Ricardo Botelho, the Chairman of the Group, Alexandre Nogueira, VP for Regulation; Claudio Brandao, Director for Corporate Finance

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and my Investor Relations team. I'd like to show you some slides and then after that we will have some time for Q&A. So, in slide 3, I'm going to skip the operating highlights because we'll talk about that a little later. So I'll go straight to the financial highlights. Our adjusted EBITDA was 764.1 million, which is an increase of 47.5% and the net income was 259.4 million, which is 93.4% above the third quarter of 2017.

With regards to indebtedness, the net debt to adjusted EBITDA ratio concluded at 2.9 times. I'd like to point out a few important events that happened after the end of the quarter. The first one is the conclusion of Ceron's acquisition process on the 30th of October. We held a general shareholders' meeting after the control was passed to Energisa, which lead to an increase in regulatory capital requirements of at least 254 million, which may go up to 282 million.

With regard to Eletroacre, due to approximately 3% minority shareholders, we have the preemptive right of shareholders. And that applies to the prior adjustment of capital to be realized by Eletrobras. So the expectation is that we'll take over control on the 1st of December and we should be subscribing to approximately 238 million.

I just like to point out that Eletrobras's previous capitalizations and the capital increases that are being made by Energisa will lead to a profound and very positive restructuring -- financial restructuring of these companies. Additionally, we will be using our experience and ex-assets turnaround of -- to make sure these concessions achieve excellent levels at Energisa is used to in very few years. The second event was the capital increase that was announced yesterday. We have kept our financial discipline, but have always guided Energisa's business. The Board has approved a private equity increase, which could go up to 579 million. In other words 5% of the current share base.

The price issuance will be BRL33.50 per units, which is a small discount on the average of the quotes of the last few days. And the controlling shareholder has stated that they keep up with this equity increase proportionately within the subscription period, which starts on the 14th of November of 2018 and on the 13th of December, 2018.

At the same time as this capitalization, we also started to negotiate the covenant indicators by so many paid bondholders in '18. We are still within the covenants' limitations and we have made this request in advance because of an assumption of the liabilities of the acquired distribution companies. Ceron and Eletroacre will show -- will increase our debt indicators at the end of the year.

As you all know, we have a very successful history in financial and operating transformation of distribution companies and we know that this increase is temporary and totally manageable. Then we'll move onto slide number 4, which is the increase of energy consumption per distribution company and consolidated. Energisa grew by 2.5%, whereas the country grew by 0.8%. As you can see on the chart below, the increasing consumption in Brazil was 1.1% and Energisa's was 2.8%. So both in the quarter and over nine months, we have maintained a 9.7 difference in third quarter.

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I'd like to point out Energisa's (inaudible) increase. However -- which was 9.7%. However, the biggest contribution came from Energisa (inaudible) which was 6.5%. Energisa Tocantins also had a determining factor in terms of the increasing residential consumption, which was 4.5% due to the high temperatures in the region and the increase in the industrial sector, which was 17.2% in the quarter. The consumption of Energisa Sergipe also showed a positive reaction due to high temperatures in the region, reporting a 4.5% increase in the residential sector and 8.5% in the business segment. And that will help due to the reclassification of clients that came from the industrial segment.

In terms of Energisa Mato Grosso do Sul, we have had more modest increases 0.9% and 0.5% respectively. And that is mainly due to the residential and commercial sectors. Because temperatures have been cleared [ph] this year when compared to last year. Last year was extraordinarily hot in the region. And we also had a shorter billing -- smaller billing in the region. The Midwest had a drop of 5.7% in September, when compared to September last year.

Now, if we can move to slide 5, please. We are going to talk about electric losses in the group. On the chart on the left hand side, we see that the total loss is 11.60% of the required energy, which is a drop of 0.26% points in relation to June 2018. When we look at total losses, we see that they have remained stable when compared to September last year.

I would say that the highlights of this quarter were Mato Grosso do Sul and Tocantins, which reached 12.35% and 12.62% respectively, which have been the lowest value since the acquisition in 2014. Energisa Mato Grosso presented a drop of 0.28 percentage points when compared to June, although losses are still above the regulatory limit. We are moving towards adequate levels. Energisa (inaudible) presented a slight increase of 0.24%, 24 percentage points when compared to June 2018 due to seasonal factors and adjustments made to electric parameters and the calculation for technical losses given, the fact that new wind power plant have come into the concession But we should go back to regulatory limits in next semester, in the next quarters.

In slide number 6, I'd like to talk about the delinquency, which is calculated by the percentage relationship between the provision for doubtful accounts and growth consumption. It's remained practically constant over the last few quarters with a slight drop of 0.04 percentage points, if we don't consider the non-recurring items the delinquency indicator would be 0.74% for the third quarter presenting a 0.04 percentage point increase in relation to the same period last year.

I'd like to highlight that this is the seventh consecutive quarter that we see a consolidated and delinquency rate below 1% even after the non-recurring adjustments made. And also, despite the crisis the country is going through, we have been able to keep delinquency under control.

And now, let's move on to slide number 7, many of our concessions continue to break their own historical records when it comes to quality indicators. All distribution companies in the group have remained below the FEC the outage frequency rate. With regards to

outage duration the DEC smarter growth were presented at 22.99 hours falling back below the regulatory limit, which is 23.09 hours and reaching the lowest value since the acquisition of the distribution company Mato Grosso by the energy is a group with a reduction of another two hours, when we compare 2018 to 2017. Out of the nine distribution companies in the growth Tocantins is slightly above the regulatory DEC but moving towards going back to regulatory limits.

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I just want to point out that IML [ph] has established that the effects of the systemic blackout that happened in March 2018 should be recorded this September. If it weren't for that, which is an event, that is completely outside our control, we would have stayed within the regulatory limits. We are appealing this decision by and now because it has also affected indicators in Paraiba, Borborema and Sergipe.

Now slide number eight, a few financial highlights and the consolidated PMSO, we see a 14.3% increase. This increase in personnel can be explained partly by labor compensations especially Mato Grosso in Sergipe, which have a corresponding entry and the reversal of provisions line of these distribution companies, and there were also regular salary readjustment and there was an increase in the teams in the region of Mato Grosso.

Well, a couple of items that are extraordinary and have had an impact on results, our provision for success fees, overall deposits in court accounting for 20.8 million. So if we don't consider the 17.1 million success fees plus these 20.8 million that come from these deposits in courts, then the increase in the PMSO for the quarter would have been 6.4% to slightly above the inflation rate for the period.

In slide number 9, there is a chart explaining a progression of the consolidated EBITDA for the first quarter, the adjusted EBITDA went up by 47.5%, if we do not consider the late payment -- surcharges there was an increase of 49.4%.

I'd like to look at some non-recurring events, which are in the chart on the right. And the first item, we see that the compensation costs have had a drop of 35.8%, then we have the effect of the Vienna [ph], which as of 2016 was considered as other revenues, which had a positive impact on the EBITDA in this quarter. And lastly, we had the effect of the success fee provision of 70.1 million.

So if we do not consider the non-recurring effects, our EBITDA has grown by 47% this quarter when compared to the third quarter 2018. This increase happen mainly due to 319.5 million improvement in Part B of the distribution companies that have had their tariffs readjusted and revised. And pointing out market growth with 142.5 million EPB was 50 [ph] million. So that it was 29.8 million, Tocantins with 20.4 million or UP with 19.7 million and Mato Grosso do Sul with 40.1 million.

In the next slide, we see the net income which has increased by 93.4%, and after the non-recurring events adjustment, we see an increase of 98.8%. In this quarter, we had some financial expense increases due to the interest of the networks to be acquired that were readjusted according to IGPM especially in Mato Grosso, so even though we reduced the balance to be included by approximately 96 million, since September last year.

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Next slide is indebtedness, our net debt at the end of the third quarter was 8.7 million. while the net debt to adjusted EBITDA ratio got from 3 times to 2.9 times. In the chart on the left hand side below, we see the progression of the cost of debt and the bank debt that was issued by index currently 81% of our debt is indexed to the CDI and we are benefiting from the drop in interest rates. In this quarter, there were two major debt event, the first one was the issuance of debentures at the distribution companies, adding up to 1.1 billion at a cost of 103.7% of the CDI with maturity in 2025 and these funds will be used in our investment program for 2018-2019. Also Moody's Fitch and S&P have reaffirmed Energisa ratings after the acquisitions of Eletroacre and Ceron. And the last two agencies have raised the ratings in the domestic scale to AAA.

Now in the next slide, I'd like to talk about our investments. We concluded the nine months with 1.276 million, the reduction of 17.4% mainly due to the conclusion of the tariff review cycle. In terms of transmission, we have made investments of approximately BRL63 million this year given the conclusion of our environmental studies at Energisa Goias Transmissora and Energisa Para Transmissora. I just like to update you on these projects that were obtained in the auction that took place in April, 2017, the constructions of Energisa Goias Transmissora and Para Transmissora one started in September and October 2018. Goias obtained its installation license on the 12th of September, only one year after the concession agreement was signed and only 15 days after the prior license was issued. Energisa Para Transmissora one also obtained the license on the 1st of October in the process that happened at the same time as the issuing of the prior license.

We believe our -- we had estimated that we would have obtained these licenses with 24 months, but we were able to do it in only 13, in terms of land and negotiations with landowners that have been affected by transmission lines are coming to an end and this suits of public utility are still ongoing. But constructions have obtained to go-ahead. In terms of Energisa Para Transmissora two, which is the last -- that was obtained at the auction in June 2018.

The concession agreement was signed in September, 2018. We have started during the topographical studies and also the construction of the environmental studies have been filed with our (inaudible) net with at least a little bit more than 30 days after concession agreement was signed. And it also fell within the tax benefit of variety [ph] at the start of this year. So these three lots add up to RAP of about 120 million and the CapEx of roughly 890 million.

Now moving on to slide 13, we have a comparison between the regulatory EBITDA and the actual reported EBITDA for the past 12 months without non-recurring effect. In the consolidated EBITDA, we are above the regulatory EBITDA, which is about 35% with a highlight of the companies that were acquired by the Rede Group, which are currently at 28% above the regulatory limit, which was 24% in December 2017.

So I'd like to conclude my presentation and we are now open for questions. Thank you.

Questions And Answers

Operator

We will now start our Q&A session. (Operator Instructions) Mr. Marcelo Sa from UBS, would like to ask a question.

Q - Marcelo Sa {BIO 16454581 <GO>}

Hello. Thanks for the call. I have two questions. I'd like to understand the follow-on. Are you just trying to lower the debt or do you want to pay the NDS's [ph] ebenture? And I want to understand, there is a risk of a new follow on to be announced perhaps next year assuming that you don't acquire more companies. So it's only the companies you have, do you think you will need to raise anymore funds looking forward? Thank you.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Thank you, Marcelo. This is just so that we can become better adjusted to our leverage levels, the close is that as you said is that the NDS court [ph] option, which will be in January. As for the procedure follow on next year, if nothing is done, I believe there will be one. We are renegotiating the covenant, according to the levels, but we believe in 2020. We should go back to zero.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Great. The next question is, I think there was an event that you took part and I think it was said that you had an expectation -- a positive expectation to recognize cost investments made by Ceron and Eletroacre, I think they have been recorded incorrectly. So could you talk a little bit about that please and explain what that is all about?

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Yes. Let me just correct something. This was announced during the second quarter conference call. We have positive expectations concerning these assets. Obviously, we are looking into it. We have many immobilized assets especially at Ceron, about 500 million to be recognized. So we have positive expectations when it comes to that.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. And in terms of terms, the appraisal for Eletroacre, do you have a deadline to announce that, to disclose that? What is to date we can expect?

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Well, for Ceron, it was 625 million for 100% of the company. We will not be disclosing the other one. We're not going to disclose the appraisal, only the total amount, yet.

Q - Marcelo Sa {BIO 16454581 <GO>}

What about Eletroacre? Do you have that figure?

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Not yet.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Okay, thank you.

Operator

Ms. Carolina Carneiro from Credit Suisse, would like to ask a question.

Q - Carolina Carneiro

Good afternoon, everyone. Thanks for the call. My question is about the regulatory levels and now was discussing through a public consultation. The regulation for the whole segment, so a public consultation, do you know when (inaudible) now may disclose it if it's going to be this year or next year. The results of this public consultation, which is a methodology for the new calculation, you think we're going to have any news about these changes so the methodology that is used, we know that that's not going to have an effect on the distribution companies, you've acquired because this will only go into force in 2020, but it's only just so we can keep up what's happening and regulatory terms. Thank you.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Well Carol, I am going to turn it over to Alexander Nogueira, he can answer your questions. Okay, just one second. Thank you.

A - Alexandre Nogueira {BIO 20586114 <GO>}

Good afternoon, Carol. Actually -- their transmission generation and distribution debate has just started and still going through public consultation and I think according to the regulatory calendar this should be concluded next year.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Okay, So we won't have any announcements this year you don't think. Well we're not expecting to have it this year. The technical teams are looking into the contributions that were made during the year of the public consultation.

Q - Carolina Carneiro

Okay. Okay, thanks. May I ask a second question.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

We have concluded the Ceron process and now we are going to start consolidating, the Eletroacre assets. The requests for tariff review of these two companies will have to be made this year. And could you talk a little bit about how the process with on how is going to work, what is the deadline for (inaudible) to give you an answer in terms of extraordinary tariff review once you have made the request for both companies?

A - Alexandre Nogueira {BIO 20586114 <GO>}

Well, the process says that the request has to be made at least one year in advance. So we believe that between the 10th and the 20th of December, we should the tariff event both for Ceron and Eletroacre. Thank you.

Operator

Our next question this is by Mr. (inaudible) from Bradesco.

Q - Unidentified Participant

Good afternoon. I'd like to understand why the net debt has increased in the period?

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

I'm going to turn it over to Claudio Brandao, so he can answer your question, okay?

Q - Unidentified Participant

Okay. Thanks.

A - Claudio Brandao {BIO 16294971 <GO>}

Good afternoon. There have been a few relevant events that have affected our debt when compared to September last year. Like the minority share in Mato Grosso, and the accounting of good derivatives to deal with convertible debentures, especially for BNDS about BRL250 million and the rest has to do with investments made by Energisa over the past 12 months. They are the events that account for the biggest figures there. And \$600 million -- BRL600 million were Energisa expanding its consumers in terms of what's not reflected in the tariff. And that's a sector cost. Energisa gets purchased.

Q - Unidentified Participant

Thank you.

Operator

Mr. Christian [ph] from Platinum Investments, would like to ask a question.

Q - Unidentified Participant

Good afternoon, everyone. Thank you for the call. I have a question about something that was mentioned before. The put option of BNDS [ph] and Energisa (inaudible) that's during January. Have they given you any signs if they're going to realize that put option? And these amounts are quite similar that you have raised. Will you be using those funds to pay that -- pay for that put option by the BNDS? Thank you.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

No, no. No, we don't think there will be realizing that put option. They haven't given us any signals to believe that. What's coming in will help us with our cash flow and our capital structure for the company as a whole.

Q - Unidentified Participant

Okay. Thank you.

Operator

Mr. Marcelo from UBS, would like to ask a question.

Q - Marcelo Sa {BIO 16454581 <GO>}

If I may, I'd like to ask another question. What is your prospect for volume growth next year. Do you have any estimate? Can you compare what you expect for the Northeast and the Midwest, the Midwest as well when compared to the Northeast, you think the Midwest will go back to growing again. Thank you.

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Well, about growth, if you look at our history, Energisa has been growing at an average of the past 15 years. 4.8% a year, always above Brazil's growth on average. Both for the quarter and the past nine months, we were 1.7 percentage points above the national average. And I believe that trend will continue. You asked about the Midwest, I think the Midwest will go back to normal. But there was huge difference in temperature this quarter when compared to the same quarter last year.

Last year was a very hot year. So obviously that affected the residential and commercial segment. Both the rural segments and the industrial segment in Mato Grosso and Mato Grosso do Sul and Tocantins are growing considerably well. So yes, we have very good prospects for the next few years based on the growth, we're seeing now.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Great. Thank you.

Operator

(Operator Instructions) Thank you. I would now like to turn the floor over to Ricardo for his final remarks. Please, Mr Ricardo. You may proceed.

A - Ricardo Botelho {BIO 2105867 <GO>}

Good afternoon. Over the next few months, our objective is to integrate the Group's new companies. In addition to the required capital in 2019, we will also realize approximately BRL700 million in investments in both concessions. Out of that 435 million will be our own capital. These investments will focus on improving the quality of energy supply in the region as well as the services provided to the population in both states.

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We have a few priorities, which are fighting losses, expanding the system. The distribution system to regions, which are not serviced, expanding and modernizing system, building new substations and lines, qualifying teams and improving our logistics in the region as well as our customer care channels. Our objective is to implement technologies and services that will improve our customer relations and our relationships with our customers.

Just as we have done at other distribution companies that are part of the Group. And during the transformation times, we use our ability to develop and to retain talent. And Ceron, which we have already acquired the responsibility is involved in the transformation and we already have it as CEO of Ceron, we have Andre Theobald. He has 26 years in the electric sector, and until recently, he was the CEO of distribution companies in Paraiba.

During his management, these companies in Paraiba will recognize regionally and nationally and won awards for best distribution companies in Brazil and in the Northeast by Abradee. With Andre as Technical Director of Ceron, we have elected (inaudible) who is an electrical engineer. He has 14 years experience in this sector and more recently was a manager pricing losses and operations manager also in Paraiba.

For Institutional Relations Director, we have elected Louise Marcello raised (inaudible) who used to be the CEO of Ceron. He is very highly experienced engineer, has 25 years experience in this sector and a great deal of knowledge of the company and the State of Parana. He will be supporting our relationship with society governments, state governments and city governments. We should announce the next two Directors that will take the positions at Eletroacre in the next few months. We have many challenges but we will use our experience to deliver high quality energy to do new consumers. We have many positive changes and we are convinced that soon. Our customers in (inaudible) will see the difference of having an efficient private operator, who is concerned with delivering high quality services with the well-being their employees and the development of the state. That is our commitment. We will continue to work to make Energisa generally Brazilian company that will become ever stronger and would like to be able to account on the involvement of all our stakeholders, and that includes you, our shareholders to do that. Have a great afternoon and a great weekend.

Operator

Thank you. This concludes Energisa's conference call. You may now disconnect and have a good day.

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