

## Q2 2016 Earnings Call

### Company Participants

- Henrique Freire, Chief Financial Officer
- Miguel Setas, Chief Executive Officer

### Other Participants

- Kaique Vasconcellos, Analyst
- Maria Carolina Carneiro, Analyst
- Vinicius Canheu, Analyst

### Presentation

#### Operator

Good morning and welcome to EDP Energias do Brasil conference call to discuss the results concerning the Second Quarter of 2016. All participants will be connected in listen-only mode during the Company's presentation. Later we will have a Q&A session when further instructions will be given. (Operator Instructions) This presentation along with the respective slides will be simultaneously broadcast over the Internet at [www.edp.com.br/ri](http://www.edp.com.br/ri). At this URL you will also be able to access the Company's results release.

Before moving on, EDP Energias do Brasil would like to mention that Forward Looking Statements made during this conference call concerning the Company's business outlook, and also financial and operating forecast concerning potential growth are based on forecasts based on the Company's expectations concerning the future of EDP Energias do Brasil. Those expectations depend on the country's macroeconomic situation and also on the performance and regulation of the electric sector besides other variables and are subject to change.

I'd now like to turn the floor over to Mr. Miguel Setas, CFO and IRO of Energias do Brasil who will start the call. Please, Mr. Setas, you have the floor.

#### Miguel Setas

Good afternoon, everyone. I'd like to thank you all for participating in this call of EDP Energias do Brasil concerning the second quarter of 2016.

Here with us today we have our CFO, Henrique Freire; and Mayte Albuquerque, our Finance Director and IRO.

FINAL

Before starting the call, I'd like to emphasize a change in our Board of Directors. As you know, that Jose Luiz Alqueres was invited for -- to become Chairman of Eletrobras and as a consequence he has resigned his post as Independent Director. I'd like to first praise his work with us and thank him very much for all the contributions he gave to EDP Energias do Brasil in the period where he worked as our Board Member.

And for today's agenda, I'll try to be brief, so we can move on to the Q&A. I'd like to start by highlighting on page four of our slide presentation. The early startup of our Cachoeira Caldeirao plant, group's one and two are being put into operation with months in advance, eight and seven months respectively as you will remember in our construction pipeline this is the second time we manage to anticipate this startup of operation.

So it deserves a duly highlight. And that's why I'd like to start the presentation by mentioning that.

Now moving on to slide number five, to have a brief overlook of the quarter's highlights. Starting of course by generation and here we mention again Cachoeira Caldeirao plant, Sao Manoel right now has reached 64% of the advancement and 70% of civil construction work. So that leaves this project within our schedule. Schedule it was established for this project and that's also very important in our view.

If we look at the operating plant, we can see that in this second quarter that the impact of GSF and PLD was lower than in the second quarter of 2015. This year minus the (inaudible) of the hydrologic risk when compared to minus 137 million last year. That of course reflects in the performance which you will have noticed by the release, which is very favorable in terms of generation.

Besides that comment on the performance, a small word about thermal plants, just to say that Pecem continues in its consolidation path. Today we have reached an 89% availability rate at the end of the second quarter, which of course reflects in its economic performance naturally.

We had in the second quarter a contribution of BRL160 million for the quarter's EBITDA and when we compare the same performance economically wide one year to the other, there we see clear differentiation in terms of performance, in terms of track record for that unit.

I'd like also to mention the accounting impact which has to be discounted in the second quarter of 2015 concerning capital gains that we had with the acquisition of 50% of the Pecem plant. So when we analyze quarter-on-quarter that is a non-recurring increase and it will need to be withdrawn just as the accounting earnings that we had this quarter. So that -- to make it more comparable, to make it that -- bring it down to a more comparable basis if you will.

I will talk about this later on, but if we eliminate this effect, our EBITDA will have seen a growth of 11%, again, without considering the Pecem's accounting earnings. So again, so

FINAL

we'd have a variable increase of 11% in EBITDA. But we'll detail that moving on with the presentation.

In terms of distribution, the second quarter was a challenging one for distribution. We had a slowdown in the market that slowed down effect in different levels distribution companies, Escelsa for example we saw a drop of 8% and at Bandeirante was a flat decrease of 0.4%. So that drop can be justified beyond market situation also to (inaudible) issue which is well known to everyone, the Mariana issue and so on.

Looking at losses, non-technical losses saw a drop both at Bandeirante and at Escelsa 0.52 percentage points for Bandeirante and 0.10 for Escelsa when we compare that to the first quarter.

In terms of overcontracting, it was less expensive if you will in the second quarter. We had a total of margin losses of around 21 million, 51.5 million in the first quarter and only 5 million in the second quarter. And as we know with the measures that the regulating agency has implemented, the perspective is that by the end of the year we will have a more favorable evolution of the overcontracting scenario.

I have also mentioned the drop in consumption to explain a drop of 8%. So that summarizes the performance in distribution. If we move on to sales and energy management, it was also a very challenging quarter. Even though we had a growth, we also saw pressure on margins both for purchase and sales and also a negative impact coming from flexibility that we offer our clients. So besides reducing consumption, we are also working with our margin of 10%, so that flexibility was used in many occasions.

And also, of course, a delay in migrations for the free market. So, again margins in the second quarter was externally pressured and hence those result.

A final word about financial discipline. Here to build that with the incorporation of Pecem, we have an increase of PMSO of 20%. If we exclude Pecem, exclude APS and PDD, APS is the company we purchased in Rio Grande do Sul and PDD has a non-cash effect, so we can look at the cost structure in a clean if you will.

In that case, we'll have an increasing cost of 2.7% -- 2.7% which is of course a better figure. And that allows us to date to have a cost structure which is way below inflation levels. Net debt over EBITDA sits at 1.3 times because of our capital increase of BRL1.5 billion.

So we're looking at now leveraging scenario, which is quite conservative. Moving on, we will be talking about the capital increase and also a highlight about the issuances that we made in the quarter for holding Energias.

So that's a brief summary. And then we can move on to page six to see a very summarized version of our capital increase. So the process was concluded successfully. A wholly subscription of BRL1.5 billion, common shares at BRL11.50 and the capital increase occurred in three phases. And in the first one the subscribed amount reached 98.4%. So,

today we have a capital structure, which is quite stronger, we have a reduction in financial cost as we prepare to address opportunities that might arise in terms of investments in the mid to long term. Today we consider that the company is dully capitalized in a very flexible manner and able to explore possible opportunities.

With that, I conclude the first part and I turn the floor over to Henrique Freire who will be talking about the impact of capital increase on the Company and the Company's indebtedness level.

## **Henrique Freire** {BIO 19117781 <GO>}

Good afternoon. We'll now move to slide number seven, where we talk about the Company's debt. I'll have reached a gross debt of around BRL6 billion on June 30th in the second quarter of the year we issued BRL250 million in debentures. And we extended the term of our debt. We also as mentioned made (inaudible) of 90 million at Energest.

Then we also made an early payment of bank credit bills for the holding in the amount of BRL300 million. And that was our highest or most expensive debt at the time. So we did it along the lines of rearranging our capital structure.

We have also evolved in Pecem. We announced the intention of reducing leveraging at Pecem. And because we do not have a debt with BNDES, we have a comfortable situation with the InterAmerican Development Bank and we expect to settle that by the end of the year. By that there might be some change in the term, but the expectation is to following in a normal path.

The result of that process is that we close this half, the semester with net debt over EBITDA at 1.3 times. If we disconsider gains that we had in the last 12 months, which are non-recurring gains and if we had considered that for Jari, Cachoeira and Sao Manoel. We will be talking about net debt-EBITDA ratio of 1.7 times. In any event it's a quite conservative level and in line with what had announced before. In this quarter, we anticipated the paying or we paid dividends at 302 million and we also took on dividends from our minority shareholders.

In the first half BRL563 million because they have some minority shareholders, we also paid as I said, 148 million in dividends to minority shareholders.

In terms of debt still the average cost of debt was 13.5% a year, including CDI and JSCP and the average term now sits at 3.41 years, which is also in line with what we had planned and with market practices and allows us to have a more comfortable cash position.

Moving on to slide number eight, we talk about our EBITDA and our net income. The first highlight would be that, in this analysis as Miguel mentioned, we talk about the PMSO. We last year had a zero basis budget, but then there were series of initiatives which were followed and incorporated into the budget.

FINAL

With that, we have a cost evolution for PMSO in terms of consolidation for Pecem and APS without computing PDD of 2.7 in the quarter and 2.4 in the half. So that's a point worth emphasizing. Who is the bad guy in PMSO, it's the PDD. PDD in distribution for Bandeirante and Escelsa has increased. We are talking about 10 million for Bandeirante. And coming from a slowdown in the economic situation and so on as you know especially in the residential class.

I like to also call your attention to the fact that there was an increase in default and also an increase in penalties and interest, which also impact our financial result. So in this quarter that reached the amount of BRL33 million. So that's the secondary affect which is natural and coming from that default level. We would like -- we need to withdraw that gain we had in second quarter of last year because of Pecem. And that's not been considered in our analysis and we also observe that on the side of hydric -- hydrology, we had an positive evolution in margins. The GSF might even have turned out to be slightly higher may be because of the low PLD when compared to last year's levels.

And the impact of the overcontracting of Bandeirante, which impacted the semester as Miguel said in BRL20 million and also noteworthy is an accounting detail, which is important in my opinion is that because of Itaipu. Itaipu causes this decoupling between the accounting register and the CVA register.

There is a fluctuation, even though it does not affect the tariff, that difference, that delta is reflected in our financial statements either positively or negatively.

In the first semester it contributed positively for distributing companies at BRL21 million. But that's not actually captured by this margins analysis. Also I highlight for commercialization, as it was said before there was a tightening of flexibility provisions in contracts and that led to a margin reduction of 25 million when compared to the same quarter of last year.

In terms of net income, like to highlight that in this period we reached a net income of BRL98 million.

Talking about other impacts on EBITDA in terms of income tax we have a result when compared to last year. Last year we had BRL120 million relative to Pecem. And this year, we also had BRL26 million in income tax which was deferred, which improved our income in BRL26 million. So that's where we have a positive impact of around BRL150 million.

I now give the floor back to Miguel.

## Miguel Setas

Thank you Henrique. I'd like to ask you to move to page number nine to give you a broader view of how we see our agenda for the second half of the year.

Starting of course with the conclusion of Cachoeira Caldeirao plant, we are now testing this third generating unit and with that we will finalize one of our main projects which is currently under construction. Sao Manoel is within schedule and within cost. We understand that the management of risks was very efficient, which assured the meeting of all deadlines. So, we will keep our focus on the active management of risk factors and on the schedule and we hope to finish the project within schedule.

FINAL

In terms of operating excellence and superior efficiency, of course we will start working to keep Pecem's performance at regulatory levels as it has been the case and on the side of distribution our focus will be fundamentally in fighting losses to make sure we can recover the regulatory trajectory based on a good PDD and a good level of default for both distributing companies.

In the third block of those highlights, we're talking about cost control and capital discipline. I'd like to highlight here a project we are currently working on in distribution and the idea is to address the OBZ, the zero based budget.

We are now working on OBZ 2.0 at Bandeirante and Escelsa and our expectation for that of course is that this will be translated into additional gains in productivity and efficiency for distributing companies. Still under the same point, we need to -- we'll focus on managing our cash post capital increase with a focus on the most expensive debt as it was mentioned before. It was mentioned before specifically the debt we had with InterAmerican Development Bank for Pecem and we hope to decrease our U.S. dollar exposure by the end of the year.

Bloomberg Transcript

And in terms of regulatory issues I have three highlights. The first one is the execution of proposals of overcontracting. The measurements announced by the government as we said before are very positive. So our expectations is that by year's end we will have solved that issue with distributors, and especially with Bandeirante we also need to conclude the periodic tariff review. That is expected to be over by August the 2nd. And finally to address from the regulatory standpoint, from the institutional standpoint as well, the hydrological situation in Ceara. As you know, the northeastern region of Brazil faces a very unfavorable hydrological situation. So we are taking all the necessary measures to make sure that from the regulatory standpoint, from the institutional standpoint, the Pecem plant will be protected should we have problems arising from that less than favorable scenario.

Of course, this topic will remain in our agenda for the second half of the year.

And finally, talking about the tariff review for EDP Escelsa, we like -- we invite you to go to slide number 10, and I'll talk about some indicators which are under public hearing from ANEEL. And which makes us very optimistic in terms of future results, especially in terms of that specific tariff review. So we have a repositioning of losses, non-technical losses of 7.87% moving to 10.76%. And in the case of Escelsa that loss will assume a flat trajectory with no change from year on year. So, this will have a very significant impact on the distributing companies' margin.

On the same chart, we can see a review of BRR with an increase of 26% in the gross area and 27% in the net remuneration basis. And that numbers we have had -- we have received from the regulatory agency and then the Parcel B in the bottom part of the slide with an increase of 10% vis-a-vis 2015. That is an expressive number when compared with our track record knowing that in our tariff review processes it's always expected to produce a reduction in the Parcel B as it happened between 2012 and 2013. And now for the 2016 review, we managed to have a positive evolution of 10%.

So, looking at this tariff review as a whole from our standpoint, there is a very favorable scenario, if you will, in terms of review for that distributing company.

Having said that, I close the presentation and we are now available for questions or comments that you may have.

## Questions And Answers

### Operator

Ladies and gentlemen, we'll now start the Q&A session. (Operator Instructions) Our first question comes from Carolina Carneiro from Santander.

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

Good afternoon, everyone. I have two questions. First, Miguel, if you could, please, you briefly commented on the overcontracting at Bandeirante. In this quarter it was less expensive, as you said, and with all the initiatives that were taken, we see a more favorable panorama, also measurements made by ANEEL it seems to be positively evolving.

My question is, do you believe those measures taken by themselves will put Bandeirante's overcontracting level within the benchmark or if they were not enough? If not, what is your expectation in terms of how much further can we see improvements from the regulatory standpoint and also from the pricing of that energy? Maybe the spot price will help, I don't know, what do you think might bring in improvements to that overcontracting scenario?

#### A - Miguel Setas

Thank you, Carol, for your question. We have a forecast for overcontracting for Bande of around 112% or seven percentage points above the regulatory levels for tariff transfer. Our expectation is that five percentage points might be neutralized or offset by the migration of free clients and special clients. Today at Bande, we do not have enough energy to replace contracts. So that migration has to be considered as a new voluntary overcontracting.

And as I said, five percentage points would be linked to special and free clients. Additionally, I would mention excellent two percentage points. We also consider that they have to consider the cancelling of contracts and an STE [ph] of new energy and as you

know the new energy sources will be included in the coming months, and that could offset the remaining of that effect. With that, we would be within the regulatory benchmark of 105%. Most likely right now, as I said, migration and then bilateral contracts and new energy still a question mark. But if we are not within the 105, we'll be close enough to that level, 105%.

## Operator

Thank you. Our next question Gustavo Castro, BTG Pactual. Mr. Gustavo, you may carry on. (Operator Instructions). Our next question come from Vinicius Canheu from Credit Suisse.

## Q - Vinicius Canheu {BIO 6300903 <GO>}

Hello, a quick question. You did mention, but I didn't quite get it. Could you please give us some more color about the IR, the income tax? Why was it so low? I'd like to understand how much of that was special or exceptional. As I see it was about half of what was expected in terms of income tax. Thank you.

## A - Miguel Setas

Good afternoon, Vinicius. On that column you see BRL120 million and there is a delta from the 150. So last year our income tax was deferred and the amount was 120. Then we have 26 million coming from Energest. And that's for five years ago, so those 26 were effectively a reduction. And then because of that, we gained credits which we can use moving forward but the final net result is 26 million in terms of impact in that period.

## Q - Vinicius Canheu {BIO 6300903 <GO>}

Okay, okay. Thank you.

## Operator

(Operator Instructions) Our next question comes from Kaique Vasconcellos from Citibank.

## Q - Kaique Vasconcellos {BIO 17317373 <GO>}

Good afternoon. Two quick questions. Concerning demand, we see a slight improvement in the second quarter. Do you have any estimate of how demand will behave in the second half of the year both for Bandeirante and Escelsa? And if you could talk a bit about the losses curve. We see a drop from Bandeirante, not so much for total losses, but then we had good results for Escelsa, but what can we expect going forward? Thank you.

## A - Miguel Setas

Kaique, thank you for your question -- for both questions actually. We forecast for year's end and evolutions in face of the current scenario. We expect continuity, in other words the volumes of Escelsa affected by the stoppage of that big client I mentioned before. In this quarter as you saw we had a drop of 8%. I'd say that, that is a scenario that we can expect for the remaining of the year.



FINAL

As for Bandeirante, we have a flat evolution, 0.4% when compared to the second quarter of last year and also for Bandeirante what we expect is to maintain that same level, slight evolutions or slight changes around that figure, 0.4%. In summary we do not see significant changes going forward in terms of volumes for the remaining of the year.

As concerned the second question about the losses, the losses review, what we expect of course is that we can continue to converge to the levels that we have currently; regulatory levels, we are close to 11% as you've seen in the presentation starting in August. And we're talking about non-technical losses. Our objective is that by year's end to converge as much as possible to the regulatory levels, which is 11%. We are now sitting at 59%. So, I'd say, if we reach 14%, I'd say it's quite favorable for Escelsa because as we all know, we are facing a scenario where losses are dropping. And of course these had a significant impact on those figures.

In the case of Bandeirante, one, we are 1% away from the regulatory level. And in that case, that's again a fine-tuning of convergence of those figures. And that's, I'd say, that's an easier "challenge", more feasible action because it's a very small difference. And going forward, I'd say that the tendency is that that difference will narrow.

So what is favorable in this outlook is that, we had losses which was close to 8% for Escelsa and that number might go down to 3%, that's a good sign.

**Q - Kaique Vasconcellos** {BIO 17317373 <GO>}

Okay, thank you.

## Operator

Since there are no more questions, the conference call to discuss second quarter results for EDP Energias do Brasil is now over. Questions sent via webcast will be answered later by the IR team. Thank you all for participating and have a nice afternoon. Thank you.

*This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*