Q3 2019 Earnings Call

Company Participants

- Daniel Faria Costa, Chief Officer for Managements & Member of Executive Board
- Paulo Eduardo Pereira Guimaraes, Head of Corporate Finance
- Ronalde Xavier Moreira Junior, Head of the Business Accounting Manager
- Unidentified Speaker

Other Participants

- Andre Sampaio, Analyst
- Marcelo Sa, Analyst

Presentation

Operator

Good afternoon, everyone. My name is Antonio Velez, Cemig's Investor Relations Superintendent. We are now starting Cemig's Third Quarter 2019 Earnings Conference Call and Webcast with the following executives. Cemig's Ambassador and CFO and IRO, Daniel Faria Costa; Corporate Finance, Management, Superintendent, Paulo Eduardo Pereira Guimaraes; Corporate Control and Planning Superintendent, Ronalde Xavier Moreira Junior; Head of the Business Accounting Manager, Leonardo Felipe Mesquita. This broadcast can be followed by the following phone numbers, 55-11-2188-0155 or 55-11-2188-0188 and also through our website, http://ri.cemig.com.br.

I'll now turn the floor to Cemig's officer, Daniel Faria Costa.

Daniel Faria Costa {BIO 20562390 <GO>}

Good afternoon, everyone. Okay and I would like to thank all of you for participating in this conference call and I would like to say that we are focusing on improving our efficiency, doing responsible work and the process is unfolding now. This quarter, we had an extraordinary effect because of the provision for social security contribution from profit shares after the current position. So we wanted to be responsible and we have taken decision for that, so let's go to the presentation.

On slide four of this presentation, we have the provision for the tax claim on social security contributions on profit share. You probably read about this on our release because we did not collect (technical difficulty) or social security on profit sharing payments in the period from 1999 to 2016. And the authority, the higher Brazilian IRS they cannot comply with 10101 for a long time. This was not considered during the period of operations and then this change and we were -- we had the authority argue that they cannot comply with us logically not previously establishing clear roles and objectives for distribution of these amounts, but the chances of loss in this dispute have been reassessed from possible to probable and you can see on the table all of the numbers.

Last (technical difficulty) we participated in an auction within having these auctions since last year and we've been very successful. We have purchased a lot of energy in a total of 798 average megawatts in the auction of the 14th, we bought a little less because of our price limit. So our goal is to purchase a little bit of energy, so it is possible then we will participate in more auctions in the coming months. Our clients are demanding this energy. So in our view, we should continue to participate in these auctions to acquire renewable supply.

On the next slide slide six, I would like to comment on this recalculation of DEC, which had an important effect because we have this dispute with ANEEL and there was probably calculation. Fall, Cemig was fined by ANEEL, they thought really not calculating that correctly, but we understood that our methodology was right. So Cemig recalculated these numbers for the years 2016, 2017. We resubmitted 2018 numbers already with the adjustments required by the regulatory agency. The product is just to show that the indicator (technical difficulty) which is the average outage duration for customer in-house under the required enrollment for 2019. So this fine was removed.

On the next slide, we talk about a topic that is very well-known to all of you, but I think it's worthwhile reminding you. This is our divestment program. So, Cemig maintains this commitment to its divestment program. So we sold 33 million shares in Light at approximately BRL18.75 per share in total of BRL625 million. And this operation gained -- generated a couple of gains in accounting gains. We have in our balance sheet close to BRL15 [ph]. So we had capital gain of BRL73 million and the result -- we had a result of remeasurement of BRL151 million. We continue to have a shareholding of 22.6% for interest stake at Light.

And moving on to slide eight, we have a summary of the electricity market. In the third quarter of '19 for Cemig D and Cemig GT, as you know, we have had a kind of flat performance. Energy and Commercial area sales remained more or less at the same level. So we can see the numbers, final consumers and energy transported. In some segments of customers there was a little bit of reduction but nothing too much. In Cemig GT -- the market of Cemig GT was down 2.2%. So we are talking about sales in the free market, traders and generators.

Please go to slide nine. Here, we have our net revenue -- consolidated net revenue in Q3 '19, we can see a lot of stability, in Cemig Distribution and Cemig GT. We had a net revenue of BRL6.071 billion, down 2.9%. For Cemig D, BRL3.909 billion, down 40% (sic - 0.2%) and in the case of Cemig GT, net revenue of BRL 1.766 billion, down 4.3%.

I will ask Superintendent Ronalde to speak a little about our operating costs and expenses.

Ronalde Xavier Moreira Junior

Good afternoon. When we compare operating expenses in the nine months or in the third Q '19 compared to the third Q '18, this increased 17.5%. So if we compare the PMSO -- the ordinary PMSO of the company, it was practically flat comparing Q3 '19 with Q3 '18. So we had a reduction in our personnel. We shared our, I'll tell you, our severance program, so we had some more expensive people and we hired some most expensive people and so as a result there was reduction in onshore services -- had an increase. This is basically associated with expenses related to the grid, monetization of the grid and preventive maintenance. This is more thinking about improving the quality of the system and maintenance of construction cost to make a regular target [ph], so it is crucial, so we improved the quality of our grid.

In terms -- not all the (inaudible) we had the provisions what we call the PL average is a profit-sharing case, so we had increased our provisions. And also post-retirement and the manageable -- some unmanageable costs such as provisions and we have the tax contingency.

For social security contributions on the profit sharing case, we did had an energy supply reduction and we can see the other numbers for construction cost, depreciation, amortization, et cetera. Please go to slide 11.

Here, we have our PMSO and gain. We confirm a dilution in our personnel costs. PMSO remained practically flat in the yearly comparison. We had an increment of almost 200,000 consumers, but still we maintained a stable PMSO level. So on PMSO, we -- comparing with the regulatory requirements, we continued along 2009. We have Cemig D setting the regulatory requirements.

In regards to the region tariff, we got the regulatory OpEx, BRL2.133 billion in the first column. We had an actual OpEx of BRL2.927 billion. But along the way, again unfortunately, we had this provision of BRL824 million for the profit sharing case. Actually BRL764 million, if we looked on at normal operations of the company, we would be practically -- would be BRL2.163 billion compared to BRL2.133 billion, which is a regulatory OpEx. Looking at the regulatory EBITDA now, BRL1.691 billion. Including the -- our profit share provision, non-technical losses, other differences BRL1.598 billion, so fairly close to the regulatory EBITDA. Now we are working a lot which is non-technical losses, which is the main manageable item that we can tackle to reach the regulatory EBITDA. Very well, moving to slide 13 to speak about our EBITDA (14:29) very clear, when we make adjustments for non-recurring events, the provisions for social contribution form half the profit sharing. In the nonrecurring gains, share, we can see that our consolidated EBITDA was BRL984 million, more than 9% increase compared to third quarter '18. Cemig D showed a result which is 35% higher than Q3 last year in EBITDA BRL618 million in the quarter, reaching levels as Ronalde mentioned very close to the regulatory EBITDA. And we have been announcing and communicating, this is like one we see growth of 21.5% and we have BRL 334 million adjusted.

Moving to slide 14, we talk about our net income. The consolidated result for Cemig was 45.3% up, adjusted BRL356 million and Cemig D more than 49% increase in the yearly comparison to BRL151 million in Cemig GT. We can see a BRL45 million net income adjusted. Last year, we had a problem with the low exchange rate, but EBITDA impacting our results because of our foreign currency at debt. Now the dollar is at a higher level, so it gave us a net income of BRL45 million of Cemig GT.

Now I'm going to turn the floor to Eduardo to speak about the evolution of our debt. Eduardo?

Paulo Eduardo Pereira Guimaraes {BIO 20547429 <GO>}

Thank you. Good afternoon. On slide 16, I would like -- on slide 15, we have Cemig's consolidated debt profile. Again, we start -- we continue with the movement to deleverage the company. And we have total net debt of BRL13.6 billion and we have a reduction in average of BRL1 billion. I'd like to highlight the reduction of cost of debt because of -- also because of Cemig's interest rate. And we showed our commitment to reduce the leverage of the company. And this reduction in leverage reflects the improvement of the company. In the past, we had an upgrade in our ratings and this collaborates this process of improving the quality of credit. The company is very much devoted to this. Please go to slide 16.

Cemig GT on 16 and Cemig D on slide 17, well, we have a reduction of Cemig D debt. We started in December of 2017, this year we were able to improve even farther the profile of our debt not only extending the average tenure of the debt, but reducing the cost of debt. We exchanged 146% of CDI to a better one. So we can see reduction in the cost of debt in our leverage, in nominal terms and in real terms. I'd like to remind you that for Cemig D in 2019, we can face the level of our net total debt of BRL5.3 billion.

And for Cemig GT, we have on the maturities time table, we made a very comfortable level in terms of cash generation of the company. We'll have to pay more in 2024 because of the Eurobonds that will mature in that year. But in 2023, our debt will be down to BRL0. We'll have to pay BRL0 debt, so we'll be in the right condition to pay the debt maturities again and then amortize it.

I'd like still remind you that 77% of our dollar denominated debt is totally hedged, which gives us comfort in terms of foreign exchange exposure in the leverage indicator. Net debt or adjusted EBITDA 3.58%. (20:45) this is what we had prepared for you regarding our quarterly results and we have the whole team here available to answer your questions.

Questions And Answers

Operator

Ladies and gentleman, we will now begin the question-and-answer session. (Operators Instructions) First question from Andre Sampaio with Santander.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good afternoon. I would like to ask two questions. First regarding debt, in fact, as you mentioned these two indicators, when will ANEEL give you a decision on this recalculation that you submitted? My second question is regarding losses, it seems to be one of the main points regarding the regulatory index. What is the strategy regarding to try to reduce the regulatory nontechnical losses?

A - Daniel Faria Costa {BIO 20562390 <GO>}

Hello. Well, actually, since we recalculated debt according to the rule, I understand that now ANEEL should give us the regular -- well, normally next year. But since we recalculated according to their requirements and adjustments that a regulatory agency ask from us, we believe that ANEEL will not cause us any problem. Can I give you a predetermined deadline to get placed? Well, we submitted numbers and we are now waiting for their regular assessment.

And regarding your question on losses, we have a number of initiatives. We have a whole program to find non-technical losses, which is basically fraud, right?Most of them -- most of these initiatives have been started to now found to be implemented, we're missing some of them, increased significantly. The number of inspections that we do on our grid and our metric, we had a very low level in the past two years ago and even before had a lot of difficulties. Our network needed to be improved by our field crews, our inspection crews and this initiative has been resumed. And I think it is now at an ideal level.

We used to have BRL200 [ph] million worth of losses. we also had a consulting firm that is working on establishing the parameters for the system to change our growth to where they need it, so that they can start cost and this is ongoing also. We need to have a budget -- a supplementary budget available and whether all of these initiatives can come to fruition? These are the main ones, but there are other initiatives, those are more strategic and specific to different segments of consumers that will allow us to reduce the losses, to purchase inspection of a public lighting, for example. And we can do this kind of work with the local government. And we have the same types of consumers, in other words, we have a number of initiatives, wherever we can work on to reduce losses, the company is bearing no efforts to improve, so that we can reduce our non-technical losses.

Q - Andre Sampaio {BIO 19422379 <GO>}

Perfect. Thank you. If I make one additional question regarding losses, do you have any expectation of the end line to achieve regulatory level?

A - Daniel Faria Costa {BIO 20562390 <GO>}

Yes, we do. Our expectation is that we'll reach the regulatory target by 2020 next year. By 2020, we have to have the system running at full speed. We are now at a phase of approving our budget and we are trying to approve all the necessary resources, so that money will not be deterrent and so that we can achieve our target by 2020. We don't know exactly in what month, but along 2020, that's our target.

Operator

Our next question comes from Marcelo Sa with Itau.

Q - Marcelo Sa {BIO 16454581 <GO>}

Hello, everyone. Thank you for the webcast. I have two questions. First, trying to understand the tax provision, not only Cemig, but other companies have similarities. We can look at the banks and the banks don't provision for this probable, so I'm just trying to understand what would you do to transition for this now in the third quarter results. I just wanted to understand how do you see in page 909 or 915, if there is a delay, will this reduce risk of the past or will it just keep the growth -- tax problems for the future? I just want to understand that please.

A - Daniel Faria Costa {BIO 20562390 <GO>}

Marcelo, good afternoon. I'll ask our lawyer to answer your question.

A - Unidentified Speaker

Well, good afternoon, everyone. Regarding the provision for the profit-sharing case, we had a ruling by TRF, the Appellate court. To put the first decision in which Cemig was involved is at the level of the Appellate court, so the court set some parameters. It was more reasonable to adopt the same parameters for the provisioning for profit -- for the profit-sharing case. We decided to follow the same parameters. This is inevitably -- all of the other rulings will consider that. Of course, we are appealing on this decision. We have been conservative because we lost in the first instance of the quarter. So, we decided to take into account case for the current and provision for that.

Q - Marcelo Sa {BIO 16454581 <GO>}

Thank you. And how do you (29:28) 905? Currently, does it solve the problem or would it impact all future cases?

A - Unidentified Speaker

(29:41) actually the point that we are studying in depth right now, this measurement dates last week. So we started a study group exactly to work on this, to discuss whether this measurement will have a retroactive effect or not? I think we are quite comfortable to say that from this moment onward, we are not going to have this problem anymore because well we are -- the negotiation of the profit-sharing case (30:28) the area of measurement. In the case of the provisional measure, it seems to me that looking forward, this is no longer going to be an issue. It seems to me that this requirement will no longer apply. But again, we are looking at the prior year to see what should happen.

Q - Marcelo Sa {BIO 16454581 <GO>}

Excellent, it is clear.

A - Unidentified Speaker

And if you will allow me, I'd like to change gears and speak a little about Renova. Cemig made a decision of not investing in fact (31:11). I would like to understand what is the rationale of the position because when we look at everything that Cemig has spend with Renova, I think a lot more than BRL1 billion that you invested in Renova with no results. This seem to me, say a little risky to adopt this strategy to continue to have a faith at Renova.

I get a little nervous about this and I think the market was too, if you need to inject more capital into Renova. So to clear the investors more comfort regarding this to have any expectation -- interacting more capital into Renova, if it in the case of Renova. So in the platform, the manufacturer does not want to give you a warranty or guarantee, so will you be able to sell that pipe? What is a guarantee that investors can have a (32:14) not in investing more in Renova.

Thank you. I'll ask Daniel to answer your question.

A - Daniel Faria Costa {BIO 20562390 <GO>}

Thank you for the question. Oh, regarding the (32:38) for Cemig to keep its equity interest in Renova. In fact, we are assessing the case, we are working with the key vendors. We will exercise our rights on Renova. We'll have to go for the revaluation of Renova as well. What is (33:38) reorganization, Renova will resort to local bankruptcy protection or incur the reorganization. So considering the company and the creditors, we now want to have a name called reorganization plan that will allow Renova to recover. So the Board of Directors together with our partners approved that we should support Renova in this process.

Regarding your question about injecting more capital. Obviously, it will be very hard for the company to recover the amount invested, right? We have to maintain our corporate activities and this is a commitment that all of the partners had to take on to support Renova in the bankruptcy protection (34:59), but this will not necessarily mean direct cash inflows from Cemig into Renova.

In conversation with other Renova creditors because of the bankruptcy protection, we are interested in providing the necessary support and we have to consider Renova's assets and liabilities, so that we can approach the bankruptcy protection plan. And this has to be done in the most adequate fashion. So we haven't got any decision in terms of injecting more capital into Renova. But we have to help Renova, sort its problem in reasonable market conditions and hopefully with a bankruptcy protect plan. This is the rationale that we are working with, with the support of Renova creditors. And we're doing this adequately and professionally with our shareholders.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay. Excellent. And I would like to understand the issue about the manufacturer, I think it was a problem regarding the warranty. So what will you do to rewind the cash flow of the partners who are paying the future debt of the company or do you intend to sell? And can the manufacture provide any kind of guarantee, is this a possibility right now?

A - Unidentified Speaker

The manufacturer is not providing a guarantee. The main objective is to complete the (37:31) as quickly as possible. This will have a major activity to connect the (37:43) campaign, we'll make a decision of selling or not and having a guarantee or not, it will all depend on the design of the bankruptcy protection (Technical Difficulty) this is not a guarantee. But when the price starts generating, we'll identify offshore contingencies. And this is what we are focusing on. And we are diligently working on that so to complete, (38:25) of the credit risk and under the umbrella of the bankruptcy protection plan.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay, thank you.

Operator

(Operators Instructions) We are now closing the question-and-answer session. I'd like to turn the floor to Cemig's Chief Officer, Dr. Daniel Faria Costa, for his final statements. Mr. Costa, you may proceed.

A - Daniel Faria Costa {BIO 20562390 <GO>}

Again, thank you very much for participating and for joining us. We had almost a record amount for the third quarter and new interest at Cemig is attracting. If I can sum it up, Cemig continues to improve operating efficiency. We are aiming to improve our quality, reduce cost and have local investments in our core business investments.

Cover those infrastructure deficits that the company had over the -- our focus is of course reduce costs and to extend the maturity of our debt, so as to have our debt comparable with our cash generation. And we aim to divest or whenever possible to release the balance sheet of the company as and when bringing returns to the company. And that can represent a capital gain for Cemig. This is our quest and we will be recognized because Fitch improved our credit rating. So again, thank you very much. We continue to work diligently to deliver the results and to even exceed the results that our investors and shareholders expect. I hope to see you on Board on the next conference call. Our IR team remains available to all of you. Thank you very much.

Operator

Cemig's third quarter earnings conference call webcast has now ended. We would like to thank all of you for participating and have a good day.