

Q1 2019 Earnings Call

Company Participants

- Andre Luis Almeida, Director of Accounting, Taxes and Asset Management
- Henrique Marques Faria Lima Freire, Chief Financial Officer
- Miguel Nuno Simoes Ferreira Setas, Chief Executive Officer and Investor Relations Officer

Other Participants

- Andre Sampaio, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and welcome to the conference call of EDP Energias do Brasil to discuss the Earnings of the First Quarter 2019. Right now, all participants are in listen-only mode. Later on, we are going to open for your questions, and further instructions will be provided.

(Operator Instructions)

This presentation together with the slides will be simultaneously webcast on the Company's website www.edp.com.br/ri. In there, you'll also be able to find the Company's earnings release.

Before moving on, EDP Energias do Brasil would like to let you know that any statements made during this conference call relative to the Company's business outlooks as well as projections, operating and financial goals relative to its potential growth are based on the expectations of the Company's management with regard to the future of EDP Energias do Brasil. Forward-looking statements depend on the country's economic scenario, the performance and regulation of the electric sector, in addition to other variables, and therefore are subject to changes.

Now we are going to turn the call to Mr. Miguel Setas, CEO and Investor Relations Officer of the EDP Energias do Brasil, that will start the call. Please Mr. Setas, you may go on.

Miguel Nuno Simoes Ferreira Setas

FINAL

Bloomberg Transcript

FINAL

Good morning, everyone. I would like to welcome you all to our conference call of the first quarter '19. I am here in this conference with Henrique Freire, our CFO and other Company officers. And I would have a brief presentation, and then we are going to open for your questions about what we present.

We are going to start with Page 3. It should give you a bit of the context of what the first quarter '19 was like. We had a very consistent quarter with regard to our results, also in line with -- Company delivers historically speaking, particularly what we had in the year of 2018. And I would like to highlight that we closed this quarter with an increase of net income by 38%. And also I would like to highlight that we had CapEx that was recorded in this period of 3.5 times more than last year. So we closed first quarter '19 with a CapEx of approximately BRL450 million, which is the best CapEx that the Company had in Brazil since it started its operations in the country.

And obviously, this movement corresponded to our transmission project. Remember that the transmission line was completed in '18, part of that is Espirito Santo. Now we are moving on to our lot 21 and lot 11, lot 11 in Maranhao and lot 21 in Santa Catarina. And also we have 18 in Minas Gerais and Sao Paulo. These are still in process of being organised. So BRL450 million, it is a historical landmark in terms of the execution of CapEx and implementation of projects.

This was a project in which we have the energy allocation strategy that we are going to see further on that moves to the second quarter part of our portfolio, before the first quarter. We had negative result of this allocation but if you think of the year for a whole especially for the second quarter, you'll see this energy as we are going to show you further on.

And I would like to tell you that in distribution, we had growth of 5.1% in distributed volume, which has a very positive impact in the results of the quarter as well. So we are talking about the business that's in absolute terms, as the impact of the bottom line has a highlight in this quarter, which is distribution, very much leveraged and as I said, transmission with the situation of investments to be performed in the lot 24 are already in operation.

Also about other businesses, you know that we have an objective of leadership in this digital and energy transition process of the segment. This quarter was also very important for that and quite significant for this initiatives. We have an increased contracted distributed solar energy. We also had the advance of our Smart Grid project. We have a pilot already in operation and is quite expensive, and we are going to give you a bit more color on that. And also the cold period is important because it contributes to the Company efficiency.

We have decreasing PMSO in the quarter. We have a project that are increasingly robotized 142 projects already now. Robots already implemented with other 21 robots extra from the previous year. And with all that, we were ranked 1st in digital maturity in Brazil especially because of this robotization process.

Henrique Freire is going to talk further on about that. But in terms of leverage, we continue at very conservative levels and our capital structure continues to be quite solid.

Now we are going to go to the next page, Page 4. And here we are going to remember that in the last year, ANEEL presented the results of its audit to 144 plants in the country. Out of this 144, we had three plants that were among the best in Brazil.

The first is the largest EDP plant in the world and obviously in Brazil, which is (inaudible) but also known as Lajeado, which was ranked 1st in ANEEL, in environmental, safety, operational, management. So for us, it was great pride and satisfaction. And in addition to Lajeado, we have Peixe Angical and Mascarenhas that were also ranked among the best out of these 144. So for us that's where operational excellence in our unit. And certainly, that contributed to this ranking.

On Page 5, I would like to give you more visibility on our energy allocation strategy. And we have 35% of our hedge today that is concentrated in the second half of the year. It is higher than the first quarter and the first half of the year. So further on, you're going to see that this results, we have a slightly negative result about BRL51 million in our energy hedge. But according to our estimates, this is going to be completely offset in the second half of the year with this asymmetric allocation of energy and dislocation to the second half of the year.

In the second half, we expect to have GSF levels that are going to be clearly at a relatively lower levels than what we had in the first quarter, in terms of energy. And therefore, we are prepared to protect ourselves in this context with a lower level of energy in this part of the year.

Going to Page 6. Well, deep down, I just want to remind you or reinforce what I already mentioned very briefly in my opening remarks about transmission lines. So lot 24, Espírito Santo completed with 20 months ahead of schedule, already generating revenues and important resources that had significant impact in this quarter. Lots 21 and 11 with already construction started. Lot 11 already with completely -- with complete initiatives. In 21, we have construction already begun. We already have licenses released for the construction. And lots 7 and 18, as I mentioned for Maranhao and Sao Paulo are other licensee. The Public Hearing for lot 18 is going to be between May 7th and 9th. So we expect those license project to take place according to schedule.

If we go to Page 7, we have some visibility on losses and distribution. And to understand the losses and distribution, it's very important to understand the evolution of our numbers. We had an increase in temperature in two states in which we operate. More than 1 degree Celsius, almost 2 degrees in Sao Paulo and 1.5 in Espirito Santo, which led to an increase of volumes in Sao Paulo to 3% and in Espirito Santo to more than 8%. So we see numbers associated to an increase in temperature.

In Sao Paulo, in terms of commercial losses, we continue with a descending curve. In Espirito Santo, we had a slight inflection as you can see here, According to, a slight increase over ANEEL's covered because of non-invoice. So in a scenario, the numbers are

growing at this speed. There is a mismatch of the energy that is invoice, that is built and the energy that is requested. And because of that, we had a decrease that is -- of 11.78%, which is very close to ANEEL's target and below the reported losses.

Also one word about the tariff revision, in this case in Espirito Santo. We know that the tariff revision in Espirito Santo takes place in August. We are ready with the first Public Hearings. And we are at a very advanced process to outline the tariff revision. I would say that the revision is very much in line with our expectation, especially a very crucial aspect for us, which is the contribution of the BRR. We are expecting a number lower than 1%. Remember that we -- in 2011, we had increases above 10%, then '15, '16, we had denials at about 3%, 1%. And in '19, we were able to have a denial that is a bit below 1%. And by denials here, I'm talking about our non-recognized CapEx. And with that -- I think that this initiative has been very interesting. And if we compare this non-recognition of CapEx compared to other cycles, this is certainly one of the lowest in the industry.

In addition to that, we want to have a real correction of Parcel B, that is substantial. We want a correction of some losses and here, we have some expectation. That's being discussing with Public Hearing. So these are technical losses. We have a revision of higher number, higher than what was proposed by the regulatory agency.

We have experienced in previous years that that can happen. We are talking basically of being able to take into consideration atypical numbers that are historically accepted by the regulatory agency. So we have a possibility of revisiting the number with ANEEL. So our expectation today is probably up to 180 that as vis-a-vis, 170 that was communicated in the Public Hearing.

So as I mentioned, non-recognized CapEx close to zero, an increase of the BRR. The market is at 25.8%. So in practice, this is going to be a consequence of the investments that we have been making and we are also going to see that further on. When we see this area of revision in Sao Paulo, you're going to have numbers that are very much similar to that in alignment with the investments made in the area.

On slide number 9, I would like to draw your attention to three areas in which we are focusing our energy, our robotization and artificial intelligence, automation of processes. Remember we have 142 robotized processes in this quarter, for a target of 170 in the year. Internally, we already have savings of costs that are a consequence of this robotization. This is something that really makes us stand out in the process.

INOVGRID, which is our expectation of having our first proof of concept in Espirito Santo, an investment of more than BRL50 million that is going to provide services for more than 58,000 customers in this region, Espirito Santo. So we already have the prospect of enjoying this process. And the photovoltaic solar energy, distributed energy, showing I think the first quarter of '18 to the first quarter '19, we had growth that was quite expensive. Today we have a 25 megawatts peak in implemented projects and we are very much active in the market.

So this is the highlight and I'm sure it's going to be a segment that is going to be part of the energy scenario of the Company in the coming years.

With that, I'm going to turn my call.

Henrique Marques Faria Lima Freire {BIO 19117781 <GO>}

So we're going to start with Slide 10. And we're talking about control of costs. Our expectation is to have better operating efficiency. And it has to do with our Base-Zero Budget. So a series of initiatives, centralization of purchases, a revisiting of contract and obviously robotization and automation processes and technology that have really contributed for us in terms of gains. But anyway, we have different initiatives. And if we compare '14 to '18, we had a gain of BRL276 million. So it is very relevant significant that we had in terms of gains. So going on, we expect a positive evolution. If we compare '18 to '19, we have a bit of a drop, nominal we inspect in PMTO. In this comparison, we have to believe that there was the effect of leases and rentals that are included in that.

We are talking about almost non-comparable expenses. So there was a slight drop. We had some credit in fiscal things in the same that enabled us to have also a very good numbers. And in transmission, we have the complexion of our Loss Fight program, optimization of services and new teams already in place. So we are talking about, a very good structure in terms of our results. With that, we're able to deliver better margins and the main effort of the Company now is to think of our OpEx-to-gross margin ratio. If you take a look at the '16 to '19, we had drops in '16, 33.3%. In the first quarter of '19, we are below 28%.

As for PECLD, this is something that we are focusing very strongly on. We are using also new technology to fight the losses, which is very important to us in the macroeconomics of our Company. It's a relevant topic for Brazil as well. And we are again are controlling those numbers below 1%. In the first quarter, 0.7%, and in '18, 0.9%.

Now we are going to Slide number 11, where we make a comparison of our corporate EBITDA and regulatory EBITDA. So we start with BRL33 million above the regulatory EBITDA, and there were some important relevance. We have BRL13 million in losses. So important losses. The market variation, a very favorable market in this first quarter that gives us BRL40 million above. Other services in general, which is just BRL1 million. But in losses and contingencies, we are already see a negative -- we still see a negative number. But again we are almost getting to the regulatory targets. And I think this is relevant and something that I would like to share with you.

Now going to Slide number 12. We have our EBITDA and net income. On the upper part of the chart, we have our distribution -- the breakdown of our business. You see that to compared to last year, we had dislocation of BRL51 million of energies to the second quarter -- the second half. So again the results are asymmetrical. There is not a perfect matching between those two numbers. Then that accounts for a lower hydro generation. Pecem, minus BRL7 million. We had a positive last year, but in comparison, we are slightly lower. Distribution was BRL48 million plus, BRL40 million related to the market. Trading

FINAL

and GRID below last year. But this has to do more with opportunities of the market that are going to be seized in the future. Transmission, a lot better. The new accounting rules demand us to register a transmission line, still as we finish it. We have finished Espirito Santo lot 24, and that enables us to seize the amount of this line immediately after it's completed. And there we entered BRL25 million positive, that are contributing to this line.

As for net income, we closed the quarter with BRL296 million. We have the projects of PLD that contributed to the effective decrease of taxes in this quarter, which led to our results.

Going to Slide 13, and our indebtedness. We are improving our net debt profile. You can see that meant that EBITDA ratio with the sale of our hydro plants last year is very much in line with our covenants of 4.2. As for evolution of term and post-tax average cost, we have made efforts to decrease our post-tax average cost. Here since 2015 to today, we had an evolution of 11.4% to 6.8%. And that has to do with a decrease in indexes but also spreads and the correct allocation of our debt in the right places.

With that, in this quarter, we had to issuances that are proof of the -- working with spreads, one was allocation of 107 of CDI and a grid that are in our project that is going to be a two-year project. CDI plus 0.15% of spreads. So spreads that are historically low that we didn't have in the past. A new line of credit for the Company in the market.

Now I'm going to turn the call back to Miguel.

Miguel Nuno Simoes Ferreira Setas

Thank you very much, Henrique. We are going to talk about future prospects on Page 14. Here, we have a connection of initiatives, the strategy that EDP announced in March in London for the whole of the Company, in the years between '18 to '22. And basically this is a recognition that the energy market is under a major transition.

Lots of things that we know, de-risking, digitalization, robotization. So these are things that are recognized as important. And EDP is clearly saying that it wants to be leader in the energy transition. And by leading this transition, we are going to create sustainable superior value in the process. So basically this is our strategic statement for the year of '19 that shows a turnaround for a sector and the transformation that we are already experiencing in Brazil. And this strategy in the view of the EDP Brazil was based on the five pillars that are crucial.

The first, double-digit growth. The second, distinctive execution. The third, de-risking. The fourth, discipline. And the fifth, driven by technology.

And basically on the next page, we have these five pillars and we have the objectives and strategies for the coming years, again to support those visions. In terms of double-digit growth, I would like to highlight that today, the Company has already closed two-digit growth of EBITDA because of the options that we were granted. As you know, we have already CapEx contracted in transmission of approximately BRL3 billion. BRL3.1 billion, to

be more exact, investments that we made is not only in transmission, but also in distribution. In recent years, we had an increase of RAB of 25% to 35%, especially for EDP's Espirito Santo in transmission. In EDP Sao Paulo, you're going to see that further on. We have a commitment to have EBITDA of more than BRL100 million at the trading company a year. And basically the idea is always to increase our cash and an opportunities for mergers and acquisitions.

FINAL

In distinctive execution, first, the advance of our works. We did that with the hydro power plants, we are doing that with the transmission lines. And the level of advances for the transmission lots is going to be more than one year in all of them. So we already have visibility about our prospects and also with very significant investments for the fight of losses. You saw that our losses are very much controlled compared to the regulatory standards. And with that, we had the recognition of ANEEL of our plans. This is something that we saw in the hydro power plant, in the thermal plant in Pecem, and now it's happening in distribution. Basically proof that the group have that in it's a strategy.

As for risks, there are three main risks. The first is the energy risk. Along the past two years, we have been able to mitigate 95% to 100% of energy risks, with investments made. This year, we are working for that as well. So this is a crucial point in our strategy of restrictive credit policy. We want to be more conservative in terms of our credit policy. Sometimes we have some flexibility in this area. But our policy is to be restrictive, so that to avoid risks. And then something that is very structural in our business, which is a large proportion of our energy agreements in the long term with a regulated market with risks, contained in negotiations in the free market. So that is about de-risking.

As for discipline, we have three important movements. First, an optimized view, a very pragmatic view of our cost structure. We want to be below 30% in the OpEx gross margin ratio. This is certainly one of the indicators that is a benchmark for the factory, if we compare to other competitors. So costs below inflation, this is a very important component. Also a very judicious allocation of capital. We always have the demand of internally having a double-digit ROE, and leverage symptoms of capital structure indebtedness, with net debt to EBITDA ratio below 2.5 times. So again a very healthy balance sheet that is prepared for growth.

Driven by technology. I already mentioned some initiatives in this quarter. But remember that we have the solar energy investments of more than BRL100 million, some EDP Ventures with allocation of BRL30 million in the next four years for startups. Also investments in Smart Grid operations, I mentioned Espirito Santo with an investment from BRL50 million to BRL60 million already announced. And today we already talked about that. And digitalization of our processes was a pioneer initiative in the segment this year. We want to have through the end of the year almost 200 processes that are prototypes.

So basically, double-digit growth, distinct execution, de-risking, disciplined, driven by technology are the pillars of our strategy for the coming years.

With that, I'm going to open for your questions.

Questions And Answers

Operator

Ladies and gentlemen we will now start the Q&A session.

(Operator Instructions)

Our first question comes from Andre Sampaio from Santander.

Q - Andre Sampaio {BIO 19422379 <GO>}

Good morning everyone, I have two questions. The first, I think that the tariff revision process is clear, the losses of (inaudible) perhaps you could have a better number in the Public Hearing. If that doesn't happen, what will be the Company's strategy to accelerate the drop of losses? That's my first question.

And second about your comments that you had in the release, of about the victory you had with fiscal themes on the 3rd of April. So could you talk a bit about that, and what the consequences of that will be for shareholders and consequently to results? Thank you.

A - Miguel Nuno Simoes Ferreira Setas

Well, thank you for your question. Well, first with the tariff revision, we've effectively do have expectations of having a higher number especially for technical losses. In the last revision, we also had this expectation which became true. So we have a high level of confidence of that. If that does not happen, as you mentioned we are going to continue making structural investments to fight losses.

We had in the cycles investments of BRL540 million. We didn't have it in the PowerPoint, because of time. But we had investments of BRL550 million to combat losses in the cycle. And so this strategy would be to continue investments -- positive investments in this level. We should not forget that the investments in smart grids, that we are having in Espirito Santo, that is already reaching its full maturity. We have over 50,000 clients almost. It's the precursor of fighting losses.

So, we do have expectations of a lower level of losses. So I think the numbers are concrete. But we do have the expectations of improving that together with the Public Hearing, but that will not jeopardize the investments of the Company. In operating technology, but as well as impacts, and really managing the networks operationally to lower our losses.

As for fiscal themes, I'm going to turn to Henrique.

A - Henrique Marques Faria Lima Freire {BIO 19117781 <GO>}

Good morning.

FINAL

Bloomberg Transcript

Yes. As you mentioned, on the 3rd of April, we had consolidated credit of our loss to Espirito Santo. With regard to PIS/COFINS themes, to be calculated together with the ICMS for the Company. This is our tax credit of BRL734 million. And Andre is here with us. He is our Accounting Tax Director. And he is going to give you a bit more color about the work of Company.

Andre, please?

A - Andre Luis Almeida {BIO 20620753 <GO>}

Good morning. This is a topic for the whole of the sector for all distributors. And it's important because of the amount involved but also because the regulatory -- legal aspects of the process. When you take a look at this credit, you have some current losses about this credit. The understanding of the Superior Court about the amount, the understanding of the IRS which is different from the Supreme Court, and you also have a pending appeal from the prosecutor's office that also is different in terms of months. So you have those amounts but there are some events going on that might change the total amount of those assets. As for the passing on and returns to consumers, remember that our regulatory asset agency is not continuing the rule that they have had since 2015.

Today, the passing on for you to pass on to consumers that bore the prices of this taxes. It is a possible destination of this amount, but it can also be passed on to the market and we don't have this clear. Again, EDP is associated with branches, the Association of Energy Companies and together with the market as well. Of course we have to have the answers to these questions very soon, for you to have a legal safety not only to the distribution companies but also to consumers. I hope I was clear.

Q - Andre Sampaio {BIO 19422379 <GO>}

So in terms of fiscal themes, you think it's too early for you to have any impact in your results? You still have to have the discussion with the Superior Court and others.

A - Andre Luis Almeida {BIO 20620753 <GO>}

Yes. I think cautious is the key word here.

Q - Andre Sampaio {BIO 19422379 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from (inaudible) from UBS.

Q - Unidentified Participant

Good morning. I would like to ask you a question about -- trading company results are bit lower than expected. We know that this is because of the change in the LV that affected volumes in the distribution company. But I would like to know what you expect from now

on. Do you think this is going to be recurring, do you think the effect is also going to show in the next quarters, so for us to get to the guidance of BRL100 million a year?

A - Miguel Nuno Simoes Ferreira Setas

Thanks for your question. Well to be very straight forward, we continue to keep the guidance of BRL100 million for the year, especially with this prospects more towards the end of the year.

And you talked about the drop, remember, but at this quarter we had to be a bit more restrictive because of -- than our counterparts in the segment. So our activity was lower than last year and therefore this quarter to us was a quarter that was below our initial expectations. But along the year we believe that we are going to recover our expectations and keep the guidance for BRL100 million that we gave you before.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

Our next question comes from (inaudible) Banco Safra.

Q - Unidentified Participant

Hello, good morning everyone. Thanks for your call. I have two questions. The first is in generation. You said that you had strong numbers this quarter and we are expecting a GSF that is strong for the year. Analyzing the numbers, it seems that EDP had a lower allocation in the beginning of the year. You're going to have higher location later on. So do you expect a more flat result in the segment along the year? Because of the GSF on allocation, what do you see in generation for the remaining of the year?

And second question too in generation. What do you think in terms of long-term contracts, a few markets, do you see a better demand? What do you see like the long-term free market, for the year?

A - Miguel Nuno Simoes Ferreira Setas

Eric [ph], thank you very much for your questions. As for performance of generation, effectively this is exactly it. We decided that to consider that we are going to have a very aggressive allocation in GSF. This is something that we are going to have in the period but our expectation as we mentioned with hedge in the second half is to have this result a lot more stable and have results very much in line with what we showed last year.

So the idea is that in the second half of the year, we are going to go back to normal with the hedge that we have allocated for the period. As for long-term contracts, we see prices are above BRL200 for 2020 and slightly lower for a longer period for 2022. For this market about BRL170. So today we see a bit of a higher price in the short term, that

FINAL

Bloomberg Transcript

according to our expectation for the period. In the shorter term a bit higher, close to BRL200 and below BRL170 as of the 2022.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

Our next question comes from (inaudible) from Credit Suisse.

Q - Unidentified Participant

Well congratulations for your results. Thanks for the call. I would like you to give us a bit more color on new project for the Company, especially concerning the new transition and energy auctions that are going to be held this year.

A - Miguel Nuno Simoes Ferreira Setas

We thank you for your question -- for your questions. We are obviously focused on four segments today. So in addition to transmission, that is certainly the cash cow of our investment plan, we have to BRL2 billion that are located for transmission, part of that already contracted. So our attention is going to focus not only in auctions, but we have a moderate expectation in the secondary market and other projects. This week, we had a very good position about those reality and so we have projects in the secondary market, and we are analyzing how the Company could advance in this area.

So transmission is our certainly most important area. Then the second block of the investments as you see are concentrated in distribution. In distribution, we would highlight our distributor and also the last get from Santa Catarina, so BRL700 million in the global distribution. And then two new segments, solar. As I mentioned before in this call, we have BRL100 million that are expected to be invested in this year and energy services in this context that we are talking about the energy transition. So the idea is to continue with our investments and we are going to have an outstanding curve of the last two segments, solar and services. The traditional segments continuing to be, but the last two segments start to show some relevance in our investment structure.

Q - Unidentified Participant

Thank you very much

Operator

(Operator Instructions)

Since there are no further questions, EDP's earnings conference for the first quarter of '19 is now closed. Any questions taken on the webcast are going to be later on answered by the IR team. We thank you very much for attending and wish you a good day. Thank you very much.

FINAL

Bloomberg Transcript

FINAL

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.

Bloomberg Transcript