

Q3 2017 Earnings Call

Company Participants

- Henrique Manuel Marques Faria Lima Freire, Chief Financial Officer
- Miguel Nuno Simoes Nunes Ferreira Setas, Chief Executive Officer and Investor Relations Officer

Presentation

Operator

Good morning, and welcome to the conference call of EDP Energias do Brasil to discuss the Earnings of the Third Quarter 2017. All Participants are in listen-only mode. Later on, we are going to open the Q&A session, and further instructions will be provided. (Operator instructions). This presentation together with slides will be simultaneously broadcast on the webcast, www.edp.com.br/ir. In there, you'll also be able to attain 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 Company's expectations with regard to the future of EDP Energias do Brasil. Forward-looking statements depends 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'll turn the floor to Mr. Miguel Setas, CEO and Investor Relations Officer of EDP Energias do Brasil, to start the call. Please Mr. Setas, you may go on.

Miguel Nuno Simoes Nunes Ferreira Setas {BIO 15901389 <GO>}

Thank you. Good morning, everyone. I would like to welcome you to our earnings release for the third quarter '17. Here, I have Henrique Freire, our CFO and other officers of our company, should be able to show you the highlights first of the month and then to establish a dialog about your questions.

We are going to start with page three of the presentation, that we have available on our website. Well, in here basically, we just give you an idea of what were our operational highlights for this quarter. This was a quarter, we are particularly happy with, because it evidences [ph] the results of a process, that you have been following for some time, a gradual transformation of the company and consolidation, both in terms of operations as well as economic finance right. Therefore the several fronts, that we are going to details to you, show that the results are reflecting the positive evolution in the three areas.

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I'm going to start with the first point, which is the Energiect Risk Protection. As you know, we are going through a current scenario energy wise, that surprise operators, markets, because we had created expectations in the end of the year and beginning of the year, when we put together our estimates, that is different from what we expected. It was not our original scenario. And I think, that the company was quite proactive in an effective manner to have to do hedging for both in water generation and thermal generation and commercialization activities could offset the risks, that are quite clear.

Hydrological risks, you know are quite clear right now and Henrique, later on is going to show to us, the impact of the whole of the risk. But, anyway, because we had a long hedge position of about 18% of our energy in our portfolio in generation, together with a specific hedging in our thermal operation and also an activity that was strategically zero opposition in commercialization, we almost could, we completely offset the loss of projected margin. So you see, we have the positive impact of hydro commercialization of about 278 and 29 million for the thermal generation. So you're going to see further on in our presentation that contributed substantially for us to establish our results with a quite adverse -- energetic scenario.

As for generation, I have two highlights. The main highlight is -- are exactly the completion of our construction of Sao Manoel, despite, all difficulties that we have last year with a change of contractors and some operating difficulties that, the change that contractors brought to us. We are still in a scenario, where we have 97.2% of physical work completion, result who are already with 155 meters of height. When we get to the point to that we are going to start the commissioning, we are going to be ready, we are now almost in pre- commissioning and so the expectation is that, we really expect an events [ph] compared to regulatory reschedule.

The regulatory schedule, as you know is May 2018 and we believe that until the end of the year, we are going to have the commissioning end product at least of the first generator, which reinforces again our positioning in generation, which is to deliver constructions within schedules, times and budgets. So I think that, Sao Manoel is another success case for EDP, its partners. And I really congratulate, the whole of the company, with the results we have had with this plant.

As for Pecem, well, you all know that this is reason of a tension in company management for some years now. For the first time, since the plant started operations in 2012, we have stabilized performance above 90%, which is with a contract committed. We closed at 91% even impacted with programs downtime and if it weren't for downtime, we would have even higher availability of this plant. But still above 90, which is our regulatory commitment. So these were the two highlights for generation, that I would like to share with you.

In distribution, I have three messages that are very important. First, volumes, as you know until the second quarter of '17, we have had quite stable volumes, that would not show still a recovery of the economy. And that have the reversal in the third quarter for the first time in the year, we had favorable evaluation of volumes particularly in Sao Paulo, of approximately 4.4% of the total distributed energy in our operations in Sao Paulo.

In the whole of our distribution, we are talking about 2.3% increase, which is again a positive message considering the context we have experienced throughout 2017. As for losses, I'm not going to go into details right now, Henrique is going to show us some charts later on. But we continue to reduce our losses with expressive results in (inaudible) particularly a more stable operation in Sao Paulo but show a positive impact in this quarter and year to date up BRL25 million. So I think, this is a confirmation that the pathway we are following in terms of reducing losses is the right way. And it makes us believe that in 2018, we are going to have a further narrowing above those gap between our losses and the regulatory losses.

And the final point, that I think, that is already clear in the earnings release up this quarter, is that we are improving our fight against delinquency rate and bad credits, and bad debt over gross revenues ratio. We are 0.6% in this quarter, which is the lowest amount that we have had in this year so far. So we have amount about 1% so for the first time, the average of the two distribution companies was below 1%.

And still on distribution, I would just like to give you a note about CapEx. As you know in recent quarters, we have been reinforcing our CapEx in distribution above the recovery quota. We had CapEx very close to QRR and now it is close to two times QFR and this is a strategy to reinforce our investments in distribution. Waiting for the next tariff review in 2019 and we hope that this will have a positive impact in this tariff review. So we are continuing to reinforce our CapEx and we are going to see numbers further on.

As for transmission, you know, this is a new business for the company. At least as a business unit, we have had serious experience in our generation units, that now we have an independent units. And you know, that we have just a scheduled anticipation of last 24, which was first line in the auction '13, '15 and it is already showing very good results in the advance of schedules and licensing that was part of our initial business case. So our prospects and at that time, we said that we had expected 10 months in advance for last 24, and based on what we have today, it can be even further than that.

I'm not going to give you hard numbers now. But in addition to what we had established in our original business case, but we are giving you signs that we can even advance that further on. So this is again a positive sign that also gives us a comfort for everything that is coming further on, like the for a loss that we had this year and that are all within the initial schedule that we had to develop.

With that, I'm going to turn the floor to Mr. Freire, our CFO, and further on I will come back for your questions.

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

Good afternoon, everyone. We are going to start on slide four and here we talk a bit about volumes. In generation, with the adjustment of sold energy especially in total hydro, we have stable contract. I will talk about the hydrological situations later on. In commercialization, we had an increase in volume of more than 50% that has to do with our proactive actions in the market.

In distribution, Miguel, already talked about that, we had the first good news in the city of Sao Paulo would growth of the market. And the highlight was the industrial market here -- the industrial production in Sao Paulo had an increase of 1.5% in the quarter. And it could take a look into our captive industrial market excluding their migration effect, which is something that continues to happen although not as much, but if we eliminate this effect, we would have growth of 7.5% [ph] . So this is something that we want to go on.

As for generation, on slide six. First, I would like to give you an introduction of the hydroelectrical scenario and outsource spot prices in GSF for 2017. You see that in the third quarter, we have a spot price of an average amount of 436.2 megawatt water, but in July it was 270. So, it was almost all the time in the sealing, so that had major impact together with GSF that was historically low 61.8% in the third quarter and shows a very deep decrease. Remember how we have the refund of GSF, you compare not against GSF but against the flat GSF. So and the flat GSF was 68, and this gap 68, 62 is not covered, it is a gap that is not covered. So, the macro in a drastic scenario was particularly a negative in general for hydroelectric plants.

What we did on slide seven, we tried to show you, this is our energy portfolio, we increased our hedge position so in the first, we have 96 mega that were decontracted that was the position that came from 2016, our natural hedge. In the second quarter, we acquired more so we got to hedging up 16% and in the third quarter 18%. So now we have a 184 megawatts average of production.

And that enables us going to slide number eight. To show you this analysis, which is the impact that we would have had if it weren't further hedging. First, is the GSF spot price impact would be an impact of BRL337 million and then we have out this reduction mitigation of this impact . So you have the renegotiation of GSF, and we have this reimbursement of 70 million, then we have the additional hedge margin of 71 that we had in the third quarter. The uncontracted energy settlement with an additional of 93. Should be considered this part of their strategy is our commercialization gross margin that added 44 million. So all this effect, the potential loss of GSF spot price came from minus 337 to minus 59 million, is still relevant that's quite mitigated.

As for slide nine, we are going to talk about Pecem. So Miguel, already talked about that -- that the advance that we had despite the scheduled downtime in the two generators, we were able to have an availability above the auction parameters that was 90 and we had -- was (inaudible) and we have 91%. So we had a very good evolution, a clear evolution since the beginning of the operation that finally compared to numbers above auction parameters.

For the energy scenario, it does impact Pecem, in the past our availability was below our regulatory landmark and we had availability factor below one and we had to reimburse those energy, 54 megawatts average and that has to be a calculated by spot prices. So we bought hedge energy in Pecem for this coverage and with that we had gains in this quarter up 29 million. So, our margin would not have been affected positively in 29 million, hadn't we have the production.

Now we are going to slide number 11, distribution. First, we have some quality indicators . You see that both in EDP Sao Paulo and Espirito Santo, we are below the regulatory standards of ANEEL, but still we increased our CapEx and therefore our programs at (inaudible) interruptions that we are going to have is going increase, but we still were below and have target in Sao Paulo with a gap up 0.2 and in present more than one hour difference.

Going to slide number 12. I think this is something that management has been pursuing very consistently along the years, which is the reduction of total losses and comparisons to regulatory targets. You'll see in the case of Espirito Santo, we are talking about technical and commercial losses. So you see that this gap has been airing a long years with consistent reduction of total losses and also -- and we have an increase of the regulatory loss in the review of 2016.

With that, now we have a difference of 1.2% and it is the quarter that the effects of the reduction that happened last year. So we have now an average of 12 months and we are fully capturing now the effect of -- the increase of the regulatory loss target in Espirito Santo for 2016. And that plays into -- it's going up 24 million a year in Espirito Santo. For Sao Paulo, we have already, also decreased the gap although we have been closer to the average before and we had gains of BRL1.2 million.

On slide 13 , we have already brought the slide in the past presentation, but it just explains the difference between our regulatory EBITDA and our corporate EBITDA in the period. So this for the first nine months of 2017. So you see that the regulatory EBITDA would be 564 million and we have for 586. Highlights 60 in losses, although we have losses, we had a reduction of losses gap, it was 48 and now in the third quarter we have 60. So we are narrowing this gap.

Then we have stilled spot prices that's are negative, provisions are different from what we have but this quarter we had a reduction of the impact, we are better than the regulatory targets in both distributors in the previous quarter that was a 31 impact and not it is 28. So we did have a recovery. On the positive side, we have our OpEx, is still below our target 37 million relevant impact and over-contracting was in a relevant impact both in Espirito Santo and Sao Paulo as we had recorded in the previous quarter. So a positive results of 46 million for this year.

Going to slide 14. We see as, Miguel, mentioned there are consistent increase of our investments. So in nine months, we accumulated 413 compared to the year 2015 where we invested 320, so a clear increase of investments and we are now at 1.7 times our CapEx QRR ratio. And basically, this is something that we are going to continue to drill in the coming quarters.

As for transmission and Lot 24, which was the first Lot that we were awarded in Espirito Santo. You see here an overview of the advance of our contract that will enable us to start construction in 2018 and our expectation is still in 2017, have the installation licenses approved. So step one was the areas study, we had an anticipation of six months, than we have the previous licensees and requests of previous licenses had an advance of 8

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months and also the license of the Public Utilities was advanced to May 17. So all these effects converge for us to have even greater advance than the 10 months we had committed to.

Now I'm going to talk a bit about our financial performance on slide 18 where some highlights. First, drove margin in commercialization, a relevant highlights, we already saw that in our energy portfolio with an increase of 43 million in this quarter, quite significant increase compared to last year. In Pecem, we added to the gross margin a 176 million, we are going to see it further on. PMTO continued to evolve below inflation. So we continue with 0.2% growth.

Adjusted EBITDA, remember that in the third quarter '16, we had a record of VNR that was quite significant when we had the review in Espirito Santo with BRL151 million and now we have an insurance interest saving of 9 million that has a positive impact of 2017. If it weren't for that, we would have an increase of 14%. Net income, an increase of 2.4%, we are going to see why the tax issue has an impact on that, but we are going to explain that as well and we keep our level of leverage side prudent at 1.9 times net debt-EBITDA.

So in slide 19, we breakdown our gross margin in '16, just to remember the numbers, we have 935 million in gross margin and now we are comparing to 864. In the third quarter '16, we had -- had the VNR, so if it weren't for this effect, we would have 777 million, which represents an increase of 9% quarter-on-quarter.

Now if we go by business line, hydro generation, we said that we had results a bit worse than last year. As for Pecem, we have 75 additional million. First the highlight is for the logistics of coal. Coal transportation that comes on road transportation had many delays in 2016 and even in the ports and the unloading that would bring us lots of penalty. So now this quarter, we could get 75 million better and this is going to improve.

We also -- we had an emergency burden that in 2016 were accounted for at costs now it had a pass on to consumers. And we had a better efficiency of the plant, increases of costs below inflation and therefore we have the reflects of 75 million in our consolidated results.

As for distribution, we're minus 151, if we eliminate the effects of VNR, we would be basically in line with last year. And the highlights in this quarter are the following. We have inbuilt certain improvement of losses, so an impact of 12 million in the quarter, vis-a-vis the quarter -- same quarter last year. And in 2016, we had some effects in our -- that impacted our accounts positively in almost 30 million, which was not -- where not reproduced this year. And therefore, we have evolution of our tariff in Sao Paulo with a positive evolution.

And in the case of Espirito Santo, the tariff in the last readjustment due to the IGPM in fact, had a slight decrease. As for commercialization, over contracting 22 million in the third quarter and to the end of the year, we are projecting to be above the 75%. As the spot prices are high, this is probably going to -- (Ends abruptly).

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