

Q2 2016 Earnings Call

Company Participants

- Alexandre Nogueira Ferreira, Economic Regulation Manager
- Cláudio Brandão Silveira, Corporate Finance Director
- Maurício Perez Botelho, CFO & Director-Investor Relations

Other Participants

- Antonio Junqueira, Analyst
- Murilo Freiburger, Analyst
- Pedro Aurélio Teixeira, Analyst
- Victor Mizusaki, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen. Welcome to the earnings conference call for the financial results of the second quarter of 2016 of Energisa. Here with us, we have Mr. Ricardo Botelho, CEO of the company; Mr. Maurício Botelho, Vice President of Finance and Investor Relations; Mr. Carlos Márcio Ferreira, Vice President of Distribution; Mr. Cláudio Brandão, Corporate Finance Officer; Mr. Alexandre Nogueira, Regulation Officer.

We would like to inform you that the participants will be in listen-only mode during the company's presentation. And after that, there will be a question-and-answer session when further instructions will be given. We inform also that this earnings call will be made in Portuguese by the company's management, and the translation will be in English, simultaneous translation.

Before proceeding, we would like to clarify that any statements made during this call regarding the business process of the company projections and operating and financial goals are based on assumptions and beliefs of Energisa's management, as well as on information currently available to the company. Future considerations are not guaranteed the performance and because they involve risks, uncertainties and assumptions. They refer to future events, and therefore depend on circumstances which may or may not occur.

Investors should understand that general economic conditions, industry conditions and other operating factors may affect future results of the company, and lead to results that materially differ from those expressed in such future statements.

Now, I would like turn the floor over to Mr. Maurício Botelho to make the presentation. Mr. Botelho, you may proceed.

Maurício Perez Botelho

Good afternoon, ladies and gentlemen. It's a pleasure to present the earnings of the second quarter of 2016 results, and as well as the first half of 2016 of Energisa.

Please move to slide number 4 on the presentation. The earnings highlights - operating and financial highlights. Physical electricity sales increased after a 0.7% growth in the second quarter period, after a 3.1% decrease in the first quarter 2016. In the six months period, we have a 1.2% decrease.

In terms of losses, 12.35% in the 12-month period ending June 2016, close to the regulatory limit of 12.3%. Of course, this has been affected by statistical impact of the decrease in the Industrial segment consumption, as well as on the market as a whole.

Energisa Mato Grosso and Energisa Tocantins' losses were above regulatory levels as we will discuss later on. In terms of default rates, there was a light improvement. We reached 2.21% in the second quarter 2016 against 2.42% in the second quarter of last year, as well as on the first quarter 2016.

This reduction in default rate had a positive impact of BRL 50.5 million in accounts receivables. The most relevant distribution companies, Energisa Mato Grosso, Mato Grosso do Sul, Tocantins, Paraíba and Sergipe had significant improvements in SAIDI and SAIFI indicators in the six months of 2016, as a result of intense investments made.

In financial terms, the highlight is the adjusted EBITDA in the second quarter, which reached BRL 384.5 million compared to BRL 315.1 million in the second quarter 2015. Excluding non-recurring results which we will discuss, the adjusted EBITDA would reach BRL 426 million in the second quarter 2016, a 35% increase compared to the second quarter 2015 or BRL 817.3 million in total in the six months of 2016.

Personnel, material, services and others, PMSO, reduced by 3.7% in the second quarter 2016 compared to the second quarter 2015. Adjusting for inflation with an IPCA of 8.8% in the period, we're talking about the actual reduction, 11.5%. In the six months of 2016, the real PMSO declined by 4.2%.

Investments increased by 13.5% in the second quarter 2016, reaching BRL 429 million, and BRL 731.7 million in the first six months of 2016. The net debt consolidated reached BRL 7 billion, which is 4.2 times the net debt over adjusted EBITDA ratio, an average cost of 101.2% of CDI with an average term of 6.5 years. It's important to highlight that this indebtedness is not yet reflected. It doesn't yet reflect the capital increase that was successful with BRL 1.5 billion of capital raised, as well as Level 2 BMF&Bovespa Corporate Governance listing.

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Please move on to slide number 6. We have the ownership structure after the equity offering of BRL 1.5 billion. I highlight the main investors, Gipar/Botelho family, FIP da Serra and Gaster, as well as Gávea fund, and the top fund Samambaia FIA. They have a lockup period of 180 days, but I would like to highlight in this slide, the total free float of the market including FIP Samambaia reaches approximately 40% of the total.

On slide number 8, we have a detailed information about the growth of electric utility market. As mentioned earlier, a growth of 0.7% in the second quarter is a reduction when compared to the first quarter. As for six months, it's still a decrease of 1.2%.

It's important to highlight as well that in the second quarter, all segments of consumption performed better than in the first quarter 2016. There is a chart in the middle showing the evolution between the first quarter and the second quarter. For example, the Residential segment was growing by 2%. In the second quarter, it grew by 5.3%. Industrial segment, which was negative by 13.3%, remains negative but less negative now at 8%. The Residential segment - or the Commercial segment dropped by 1.2%. It's still negative by 0.9%. The Rural segment really changed. Surprisingly, it was negative by 2.4%. It is now positive at 11.2%.

It's important to highlight as well that Energisa Tocantins was the market that grew the most. It grew by 11.3%. The Midwest distribution companies grew by 2.2% in the period and Southeast grew by 1.1%. Northeast region decreased by 4.6%, nevertheless, less than the first quarter, which was 8.4% negative. So that indicates that there is a slight recovery of the market. In comparison, in terms to the national market, Brazil consumption decreased by 1.7%, whereas Energisa's sales declined by 1.2%. Also, comparing to the Residential segment in the country, Brazil increased by 1.2%, which is a lower increase when compared to the Energisa's 3.6% performance.

Now moving on to slide number 10, we have the operational highlights. We have the evolution of SAIDI and SAIFI comparing the fourth quarter of 2013, which is before we acquired Grupo Rede and then SAIDI and SAIFI consolidated figures. We see a significant changes in SAIDI and SAIFI, and both are now below regulatory limits.

In terms of losses, there has been a growth in losses lately, partially explained by statistical factors. But we also had an increase in total losses especially EMT and ETO. In Mato Grosso, the total losses reached 15.3% and 14.8% in Tocantins. These are 1.5% higher than regulatory level for EMT and 0.7% above regulatory limit for Tocantins.

Of course, management is worried about these increase in losses. We have experienced these in the past during crisis and that happens usually, but we are focusing on controlling losses in order to go back to normal levels of losses.

Now, moving on to slide number 12, financial highlights. We show the controllable expenses here. There has been a growth of IPCA of 8.8% in the period, the inflation, and we grew by 4.6%. And controllable expenses declined by 3.7% in the second quarter 2016, which is a significant increase or evolution link up with inflation.

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In terms of increases, we have personnel increasing by 24% in 6 months, BRL 86 million. This increase in personnel is associated to the strategy of hiring more employees and decreasing outsourced services. And this is why there is an increase in the number of employee, 4.4% increase in the period. This increase in the consolidated terms accounted for BRL 25 million and BRL 22.3 million.

The personnel increase has wage and benefits adjustments and BRL 41.1 million consolidated terms and BRL 33.1 million at the distribution companies. Also associated to that, we have extra costs for restructuring personnel costs and indemnities at BRL 10 million, and BRL 9.6 million of other effects, especially private pension funds and actuarial deficit amounting to BRL 6 million. A reduction of outsourced services, 12.4% reduction in the six-month period, BRL 43.3 million associated to an increase of our own staff.

Now, moving on to slide number 13, we have the financial highlights with the adjusted EBITDA evolution we have composed of managerial EBITDA and reported EBITDA. On the left side of the chart, you may see that in six months period reported BRL 822.5 million. And then we have CVA effect last year, which favored the result of 2015 CVA from periods before 2014 including. And the EBITDA for six months would be BRL 776.5 million in the period.

Now, the reported EBITDA in 2016, we have a market decline as mentioned, a BRL 43 million decline in the market, a reduction - the O&M, PMSO, BRL 19.2 million. Other costs and provisions, BRL 23.1 million, reaching the reported EBITDA for the six months period of 2016 of BRL 775.8 million. There was also an effect of CVA generations disallowance that's associated to previous periods, availability agreements of out-of-merit dispatch that accounted for BRL 41.5 million, which would reach the managerial EBITDA of 2016 for six months to BRL 817.3 million. So comparing the two EBITDAs managerial for 2015, as well as managerial for 2016, an increase of 5.2%.

Now, slide number 14, we have net earnings. It's important to highlight this, because in 2015, we had sales of assets. In six months last year, we had a BRL 325.5 million income and some non-recurring effects such as the sale of assets, which contributed with BRL 404 million. On the positive side, we had the amortization of premium from the acquisition of Grupo Rede's companies, especially the concessions of São Paulo and Paraná, whose premium was truly amortized into June next year. So this is something that didn't happen this year.

So we have an extra BRL 101.7 million, which had a negative impact last year on the company's net income. We have the CVA period. CVA, which was accounted for in this period, BRL 32.2 million after taxes. The same equation for the generators disallowance, which accounted for BRL 41.1 million and BRL 33.2 million after taxes.

So this is a significant change in the results. See, the managerial earnings in the six months of last year should have been a loss of BRL 9.7 million against the positive result this year of BRL 130.4 million. So that's an evolution of BRL 140.1 million in managerial net income.

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On slide 15, we'll have main financial highlights about the consolidated net debt that has been an important changes in the cash and cash equivalent position for the third quarter - second quarter. We are now at BRL 2.561 billion, and this is equivalent to amortization in 2016 and 2017 joint figures. And these are figures before the capital increase, which amounted to BRL 1.5 billion. This would lead the pro forma cash position that would be equivalent of two, three years of debt service.

The relative indebtedness is 4.2 times at first Q16, BRL 7 million in 2015. The pro forma would be BRL 5.539 million, and the debt ratio would be 3.3 times.

In terms of net debt by type of index, it's important to highlight that all the U.S. dollars options, we can see exchange rate improve this year. We now have a U.S. dollars with cash of 28.7%. It has a swap to reals. So, we do have CDI. CDI accounts for 28.7%; IPCA, 17.5% of the debt.

Now, moving on to slide 16, we have consolidated investments made in the quarter compared as well as compared in for the first half of the year. That 77% of investments were made in the companies acquired from Grupo Rede with an increase of 24%. Another item to be highlighted is the companies that will still undergo rate cases, Energisa Paraíba and EPB and EBO in 2017 and EMT, EMS and ESE in 2018.

On a consolidated basis, these companies' investments increased by 25%. Mato Grosso is a company that has the most investments, BRL 282.6 million, followed by Tocantins, BRL 131.5 million, and then Mato Grosso, BRL 107.5 million in investments.

In terms of tariff review, there have been tariff reviews in the acquired companies from Grupo Rede, also Energisa Minas Gerais, Nova Friburgo, and Tocantins underwent tariff reviews. The companies acquired from Grupo Rede São Paulo went a tariff review in May of this year, Minas Gerais, Nova Friburgo, and Força e Luz do Oeste in June this year, and Tocantins this year as well in July. There has been a significant evolution in the asset base. It has grown by 70.3% with a variation of BRL 607.7 million. Other companies will undergo this tariff review still.

And on rate cases, we have the evolution of Parcel B on the following slide, slide 19. And the companies that underwent detailed review that accounted for an increase, and the companies that Mato Grosso do Sul, Borborema Energisa increased by BRL 104 million, total to BRL 286.5 million. But still, we have to include initially the Paraíba's tariff adjustment that will be in August this year. We estimated out of these adjustments due to tariff reviews in 2016, BRL 49 million effective positively EBITDA in the quarter. And BRL 45 million for the six-month period.

Now, moving on to slide 21, the subsequent event after the public offering for equities that was completed in August 3 with BRL 1.5 billion. And also, level 2 BMF&Bovespa corporate governance listing. The price was set at BRL 18.5 per unit ENGI11, which is comprised of one common share and four preferred shares, increasing the total company capital to BRL 2.796 billion. The company reduced its leverage, approximately 40% - free float, reaching 40% of total shares outstanding.

On page 22, as the exceptional amount traded, BRL 448 million in the first day after the IPO. And then it reached the normal trading volume and the weighted average - weighted traded volume is BRL 65 million since the beginning of trade.

And I now end my presentation, and it's available for the Q&A session. Operator, please.

Q&A

Operator

Thank you. We will now start the Q&A session Mr. Murilo Freiburger from Bank of America has a question.

Q - Murilo Freiburger {BIO 17385357 <GO>}

Good afternoon. Thank you for the opportunity to ask a question. First, over-contracting topic. We had said that the maximum impact for this year would be BRL 140 million for this year. Both the stock price and measures they were taking could change that. Do you have a more updated account of this possible impact?

And also the concentration, assuming now that you no longer need to buy 96% of energy, I believe that this problem would be almost 100% solved for next year. And in fact, for the third question, in volume, we had a strong recovery in the second quarter. What do you expect for the second half of the year?

A - Maurício Perez Botelho

This is Maurício Botelho speaking. In terms of over-contracting, with its positive movement, also bad debt, provisions and the end - or stock prices, we expect an estimated loss of BRL 19 million, but we believe that there's mitigating actions that are being discussed with the government because I want to get rid of this over-contracting problem in 2016.

The second question was about the market, right? Right now, we are not giving any guidance in terms of growth projections, given the uncertainty of the economy. It's very hard for us to estimate that, and give any guidance to the markets about the market development. As we have said, the first quarter was quite bad for Brazil and Energisa, and we felt a significant improvement for the second quarter of this year.

Q - Murilo Freiburger {BIO 17385357 <GO>}

Thank you, Maurício.

Operator

Victor Mizusaki from Bradesco BBI has a question.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Good afternoon. I have two questions. The first one, the government just announced the option of (29:14). If you could tell us if there could be any change whether this option becomes appealing, attractive. And also about the earnings, looking at the costs in other expenses and controllable expenses, there has been a significant drop in that. Could you detail what happened in that line of controllable expenses, please?

A - Maurício Perez Botelho

Victor, are you talking on page 13 of the presentation? Or rather ITR, page 13. What line were you talking about because it was a bit low, the connection, on the presentation.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Yes, on the presentation on slide 12, the controllable expenses. If you could talk a bit about operational performance of costs. And there is a detailing, you're talking about default and then other expenses with a significant decrease. If you could give us some more detail about what is included in that line, please?

A - Maurício Perez Botelho

Just a second. Victor, we're looking here on a six months period. It goes from BRL 89 million to BRL 84 million in the quarter. Maybe something seasonal. There have been penalties, decreased penalties charged by a new decrease, and that probably is related to that. It's between BRL 85 million, BRL 90 million as you said.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Would this be the level for the semester, or could we expect lower levels like the quarter, around BRL 20 million-something?

A - Maurício Perez Botelho

As a reminder, on December 31, 2015, in the second half of last year, there was an issue, and other companies that were under intervention, we had a double penalty. So for example, for Mato Grosso, last year the last quarter, BRL 12.5 million in penalties were charged, which is the conversion of penalties into investments that are not remunerated. So Mato Grosso, BRL 25 million, so this could be a non-recurring event in this comparison.

When you look at the year as a whole, BRL 12 million more for Mato Grosso. Total was BRL 25 million, so actually BRL 12.5 million in penalty plus BRL 12.5 million extra converted into investments. This situation does not apply starting on 2016. It only applies until the end of 2015. So if there is a penalty, it won't be double penalty, as it happened in Mato Grosso. That's a good sign. In the first six months of 2016, it's a good sign of what's happening.

Q - Victor Mizusaki {BIO 4087162 <GO>}

What about Sergipe?

A - Maurício Perez Botelho

Well, we mentioned that before in other calls, we believe that the company is not properly priced.

Q - Victor Mizusaki {BIO 4087162 <GO>}

Okay. Thank you very much for your answer.

Operator

Antonio Junqueira from BTG Pactual has a question.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Good afternoon. If possible, could you elaborate a bit more on the performance of the following concession, Mato Grosso, it was surprisingly up. Minas Gerais and Mato Grosso do Sul had the opposite performance. I know you have many concessions, but if you could detail a bit more, if you see that anything specific happened on the concessions to explain these relative performances.

And also, if could give us some more detail on the CVA disallowance of generations when compared to other distribution company that was not so common. Could you explain that item a little bit more? Why is it that it treated differently from the regular CVA? Thank you.

A - Maurício Perez Botelho

Just a second, please. When you compare the markets, Minas Gerais had a more significant market decrease, for Minas Gerais some industrial customers which undergoing problems, which had almost - were disconnected on a permanent basis, which explains this more significant decrease in Minas Gerais, which is small region as compared to the others. As for Mato Grosso, it's the dynamics of the market. If the market is smaller, and therefore it's growing more. In terms of CVA, I'll let Alexandre answer for you.

A - Alexandre Nogueira Ferreira {BIO 19917568 <GO>}

Well, with regards to your specific questions about disallowances considered in the second quarter, it's worth remembering that out of the 13 concessionaires, 11 had their tariff duties concentrated in the second quarter. And that explains the amount of disallowances considered.

What are these disallowances? These result from an audit conducted by ANEEL about CVA amounts from 2012 to 2015, and since August 2015, ANEEL is using this new procedure because there were some thermo dispatch contracts according to availability. And given this change in the procedure by the city and the criteria of invoicing of those thermo plants, ANEEL is disallowing amounts that were transferred to consumers in the tariffs and allowing them to have a refund from the generation companies amounted to BRL 33.2 million in the semester, and we were able to exercise BRL 21.8 million with a negative effect on EBITDA of about BRL 41 million.

Some of these disallowances after an audit, we'd expected that they did not apply, and they were not properly done, and we want to have that recognized in the next tariff review, in Paraíba tariff review, in which the first disallowance occurred in 2015, and the tariff to be approved shortly will be able to reverse BRL 7.5 million due to undue disallowances that were made by the regulatory authority.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Is there any reason for this to affect the EBITDA? Wasn't the EBITDA higher in the cash flow? Why is this impacting in EBITDA?

A - Maurício Perez Botelho

Yeah, it's not included in the cash flow.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Okay. What was the difference for them to be here?

A - Cláudio Brandão Silveira

Antonio, this is Cláudio Brandão speaking. Good afternoon. What happened is that the CVAs were created between 2012 and 2014. It's already included in the tariff of distribution companies. And now, since its negative effect of the CVA, this is being returned to the tariff events as they happen. It used to be cash in the past, and now, the provision is being made through the CVA to return those funds or refund them.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Okay. Thank you.

Operator

Mr. Pedro Aurélio from CanalEnergia has a question.

Q - Pedro Aurélio Teixeira {BIO 4308147 <GO>}

Good afternoon. I would like you to talk about the (39:33) and if the price has been reviewed and revised that you would be interested in. But it seems you have talked about that already.

A - Maurício Perez Botelho

Yes. We're not looking into that company right now, the Sergipe. That's the answer.

Operator

Since there are no further questions, I would like to turn the floor over to Mr. Maurício for his final remarks. Mr. Maurício Botelho, please continue.

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A - Maurício Perez Botelho

I thank you all for attending this conference call. Next quarter, we'll also have a conference call including the company's capitalization that will give you a different view at least on the financial aspect. Thank you very much for attending the call and have a good afternoon.

Operator

Thank you. The conference call for the earnings of Energisa on the second quarter 2016 has now ended. Please disconnect your lines now and have a good day.

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