

Q3 2014 Earnings Call

Company Participants

- Leonardo George de Magalhaes, Superintendent of Controllershship
- Luiz Fernando Rolla, Chief Officer for Finance & IR
- Marcus Vinicius de Castro Lobato, Head of Power Trading Planning
- Robson Laranjo, Investor Market Manager

Other Participants

- Vinicius Canheu, Analyst

Presentation

Robson Laranjo

Good afternoon, to all of you. My name is Robson Laranjo. I am the Investor Market Manager of Cemig. At this moment, we will launch our video webcast with Cemig's Third Quarter results for 2014.

Attending this meeting are Dr. Luiz Fernando Rolla, Chief Officer for Finance and Investor Relations -- Dr. Leonardo George de Magalhaes, Controller -- and Dr. Marcus Vinicius de Castro Lobato, Head of Power Trading and Planning.

(Operator Instructions)

To begin our presentation, I will hand over the floor to our Chief Officer for Finance and Investor Relations, Dr. Luiz Fernando Rolla.

Luiz Fernando Rolla {BIO 1852035 <GO>}

Thank you, Robson. Good afternoon, to all of you. It's, as ever, a pleasure to introduce our results as every quarter, presenting the results to the market of the Cemig Group.

President Djalma Bastos de Moraes unfortunately could not attend today. He had his emergency trip to Sao Paulo, unexpected trip. And he asked me to convey to you a message filled with trust and comfort with regard the results that we are delivering to you today.

I, of course, am not wearing a tie because of other reasons. I will be traveling soon myself. But I have my colleagues, Robson Laranjo, Marcus Vinicius, to deliver the results from our

Third Quarter, very complex results having in view the context -- the present context of the electrical sector. So that requires our experts to explain to you our results.

As always, we are including some projections. And you should consider all the aspects that should be considered in our waiver -- or disclaimer. Our financial results are organized in accordance to the principles of IFRS, the accounting principles adopted today in Brazil.

In our three top indicators that we usually present to you, we had some behavior that we will present to you. Net revenue had a very substantial 25% increase. EBITDA as compared to the same period last year had a small 2% growth. And net income had a negative impact, minus 11%.

Over our presentation, we will try to clarify each of these indicators and why we got to these figures. But as I said in the beginning, our context in the energy market in Brazil is rather complicated at the moment.

We had to allocate our capacity in the First Quarters. And there is a lower cash injection in the Third Quarter. And we had a substantial decrease in GSF. We estimated 90%. And in the end it proved to be 82%, 82%.

That impacted all companies of the group and with a relevant impact on some of our subsidiaries, for example in Madeira Energia. During our explanation, we will strive to explain to you what exactly happened.

We had a substantial reduction in income, much higher than the accumulated decrease. We still have some progress to do in the Fourth Quarter. But the highlights are rather positive in this quarter, first of all a BRL1.5 investment in Renova.

We acquired an outstanding stake in that company in this area of generation from renewable sources. That's a top quality investment expected to generate great results in the future for Cemig, having viewed that Renova has demonstrated competence, quality, not only in constructing wind farms, the best in Brazil. But also costs and investments much lower than the average.

You have been following the success that Renova has achieved in successive auctions, acquiring long term contracts at very positive values, bringing in a very good remuneration for their investments.

So Renova is a factor for growth into the next years for Cemig because the potential for growth, as you'll see later on during this presentation, is rather relevant.

As for Taesa, Taesa is an investment that we can consider to be very stable as for results. However, in this quarter there was a change in its ownership structure. The Coliseu fund was extended for 720 days with a deadline for October, according to our documents with SEC.

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But they maneuvered for another 720 days. But they have been a very positive partner in our management at Taesa. They have provided us with the conditions to have a very good expertise in financial administration of that company with very good fruits and dividends.

As they disclosed on the 10th of the month, cash generation and income are very strong. And that points at the correctness of our decision to invest in these assets.

Also, for natural gas, we had a substantial movement in terms of the growth of our participation or stake in Gasmig. We have announced to the market repeatedly that natural gas is another very relevant factor for growth in Cemig into the various next years.

And this increasing stake in Gasmig, reflecting problems faced by Petrobras as for funding for investments, they decided that they would not be able to support that growth.

And they elected to sell a stake. And we acquired 40% interest previously held by Petrobras at a BRL600 million price tag. And now we are in a very strong position with Gasmig and in position to implement its expansion program, as we shall see soon.

As for hydraulic area, in our plan to restructure our generation portfolio, we acquired almost a 50% interest in Retiro Baixo Energetica. That's a company that manages the Retiro Baixo hydro plant located in Minas Gerais.

We acquired an almost 50% interest in that plant. That's part of our strategy to grow in the segment of generation, which we also consider very promising for the upcoming years.

As for sustainability, once again Cemig was included in the Dow Jones' Sustainability Index. And this is a certification of our sustainability practices implemented by Cemig over long years. This has brought a very good reputation to Cemig among investors that are socially responsible in their investments.

Also, we shall talk a little bit about the Santo Antonio hydroelectric plant. It has undergone a few difficulties. There was this strong polemic relating to the Santo Antonio plant, a very heated debate and discussion with ANEEL and the SEO, the agencies involved in the electrical sector, trying to mitigate the problems that Santo Antonio has gone through recently.

More relevantly, the non-availability factor, FID in Portuguese, referring to the availability of the machines during the construction phase, our contract states that this availability should be 99.5%. We believe this is perfectly feasible. And as soon as we have 100% of the rotors in operation, we will have 100%.

But because it's under construction, we are in discussion with ANEEL and IMES [ph], trying to adjust this index during this period. Trying to mitigate -- and this will certainly mitigate the costs in the tapping of this source of energy for their shareholders.

That involves substantial costs. And as we understand -- our understanding with the regulatory bodies lead us to cover much of those costs.

Another significant item should be associated to the illegal strikes that caused some delay in the startup of rotors. We have applied with ANEEL, the national agency, to postpone days of sales contracts with distributors by 63.61 days, as derived from the force majeure facts that prevented Santo Antonio Energy to deliver the rotors by the predicted dates.

Another important factor is GSF. All of you have followed this issue related to the electrical sector. That has to do with the hydro -- the water shortage situation in this dry season recently affecting substantially Santo Antonio Energy.

This is, of course, a natural circumstance. It has to be with a context right now that it affects the short term. But it brings no long term concerns.

We have decided to expand our interest participation in the plant because we understand generation is good business, especially in the Santo Antonio plant, whose performance as for energy is very stable. And over time, it will bring all the benefits we expect and that we expected when we decided to go into acquisitions, in keeping original sources and acquiring new assets at this very substantial rate.

We have a contract signed with Santo Antonio and Andrade Gutierrez SAAG, where the contingency clauses exempt Cemig from disbursements. And that protects us from exposure to spot market. And so, we believe we will have no consequence -- undesirable consequences coming from this.

Also for Renova, we also -- we capitalized Renova. As I said, we increased our stake. That means 36.6% in voting capital.

The first movement was a FAQ, an advance against capital increase of BRL110 million. And also BRL700 million of the interest in Brazil PCH. This brings, in the short term, stability to our cash so that credit would be in a better position.

Renova is not exactly a startup. But it is restructuring most of its capacity to produce energy, although they already have 2,000 megawatts under contract, be it under regulated environment or otherwise.

As I said, this should -- this holds a very promising future with the potential for growth that's very strong. They may reach as much as 7,000 megawatts with existing structures. This shows that it may become a very relevant company in the context of the Cemig Group.

As for the Coliseu fund, as I said, this contributed very substantially for us to achieve the success as we did in acquiring Taesa. Corporate governance as implemented allowed us not only to substantially increase and improve Taesa's performance. But also selecting

very properly the expansion plans and the opportunities that we had for further acquisitions.

And that lent to Taesa its financial structure of such scale. And that points to the correct decision we took. In the first semester, the profit it yielded was very substantial already, reaching BRL497 million in the quarter in income. So that demonstrates the quality of its assets.

And by decision of stockholders in the Coliseu fund, some movements, especially by Santander, created a parallel structure that has linked funds. And Santander as the sole unit holder in that fund.

That changed a little bit the corporate governance structure without, however, impacting our strategy of shared management. With a number of shares and with voting rights already in place, we kept this characteristic that, as I said in the beginning, ensures the success that Taesa has been acquiring.

FIP Coliseu has a little fewer common shares than Cemig. But according to the structure of shared management, this could be preserved. And this will keep on giving Taesa this characteristic of a private company.

With regard to sustainability, as always, we have attracted a lot of recognition from the market. We selected a few of these tokens of recognition, demonstrating that our practices are widely recognized by our investors, those in tune with the corporate sustainability principles in various opportunities.

We have listed our main practices. But I would like to highlight three points only that show how committed we are to sustainability. Cemig GT has 98% of its generation capacity from renewable sources.

Renova reaches 100%. Recently in the latest auction, it included solar power generation. And Cemig adds to its scope this totally renewal source.

Also as for the hydro expansion, which is also 100% renewable, as I said we acquired 49.9% of Retiro Baixo hydro plant. And that restates all of our commitments.

Power generation portfolio, as we see in slide number nine, we can see that today in operation we have some 7,600, almost, megawatts, contracted more than 1,300 -- all together 8,906 total megawatt capacity.

This has to do with our expansion strategy. And the return of some of the plants -- some of the concession contracts expired, especially those 17 plants that have to be returned in July 2015. But this will not impact significantly our generation portfolio because we will replace them by these new acquisitions, a huge capacity under contract.

And this transition can be made very smoothly so that cash generation for Cemig GT will not affect our commitments to our clients. And especially having a view -- current contracts and especially long term contracts.

Santo Antonio and some units will start with almost 100% of assured generation. Some other units and rotors will start operating. 32 are already in commercial operation. Within the next 12 months, we will reach 100% operational level.

For Belo Monte, we should start 24 motors from February 2016. That has a substantial impact on the long term supply. That's a very important plant for Brazil as a whole. And it will add more capacity to Cemig in the long term.

Our stake is around 10% already. And as opportunities arise, we'll acquire even more capacity.

Renova, as I said, has an already installed PCAs [ph] and wind power. Under construction is something in excess of 560 megawatts average at Alto Sertao II. And already contracted another complex with wind farms with around 500 megawatts average, which in terms of -- all together can add 2,000 megawatts of generation capacity.

This shows again, as I had highlighted before, the promising future that should be brought by Renova to Cemig.

Another point that we have insisted on with the market is natural gas, with a very positive growth in terms of the natural gas volumes sold in 2013. We exceeded 1.4 billion cubic meters sold, particularly to the industrial market, 83% of the total. And the remaining 13%, 14% went to thermo plants in general.

And we started a process at that time of selling natural gas to residential consumers, a series of investments in 2014 expanding supply in our network of gas pipelines in cities like Belo Horizonte in particular.

And this is a plan that's also very promising and should increase the volume of natural gas sold, nearing very close to 4 million cubic meters per day. This will lend Gasmig a very robust economic dimension and will allow the financing of future expansions that we plan, especially when we have further supplies available.

So these were the aspects that we would like to discuss with you in terms of the results. And now let's concentrate on the Third Quarter results accumulated.

As I said, 25% increase in net revenue. Free market was very significant. Industrial consumption increased by 2,340 megawatts per hour.

This was much above what we had sold to the spot market. This was the movement that happened that meant all together 4% increase in sales volume. And January/February saw

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a very strong increase in consumption due to the high temperatures in the especially hot last summer. This was one of the components in this 4% increase that we can see.

Of course, we are now expanding our client base. With regard to distribution, Cemig has reached 8 million customers. I can remember no other utility with such a large number of customers with Cemig distribution. That's probably one of the top or the top supplier in Latin America in terms of number of customers and consumers.

As for operational expenses, also a substantial 23% increase, very similar to the previous quarter, 22%. And the main component of this growth was expenses associated with purchased electricity.

This has brought us some significant impact in recent semesters and quarters. We had a subsidy transferred to the final consumer by the government, almost BRL2 billion. I would like to expand those numbers if not for these subsidies.

We have already accounted in our regulatory assets with SEC. And this will be replenished next year with an increase in tariffs. But unfortunately we did have these increases in expenses associated to purchase electricity.

As a consequence, EBITDA grows only 2%. These are modest figures in view of what we had intended. But that's as a function of those contracts we are describing to you.

If we compare EBITDA in 2013 with 2014 without the SEC adjustments, we would have a substantial 20% growth intending with the increase of revenues. But unfortunately we had these impacts. And the volume of adjustments was very strong. Therefore, we had a modest 2% increase in EBITDA coming to almost BRL4.200 million in the end of the semester or the quarter.

We reached BRL513 million as against BRL1.2 billion more obtained in the same quarter 2013. These results are somehow part of our planning. And naturally, this is part of our trading policies.

We should assign priority to the first semester in the investment in further generation. And now we feel the impact of the GSF. This value has been rather strong indeed.

But we are reaching the lower limit of our guidance as disclosed in May last year to our investors. Consolidated net income, we had a reduction of 11%, especially explained by the impact of the negative equity income in Madeira Energy.

This was very strong. And that derived from the same problems as we described before.

Leonardo George de Magalhaes {BIO 21639277 <GO>}

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Dr. Rolla, the impact of the whole reached these BRL330 million and concentrated in this Third Quarter. But this GSF has been affecting other operations, Santo Antonio. But in the coming months, this will be much lower than what we reported in this last quarter.

Our profit this year would be 10% above last year's if not for these interferences. But Taesa, for example, last year also translated into a very strong gain.

But if we made all these adjustments, we are sure not to see this Madeira effect happening in the next quarters. Even so, we can see in the accumulated results a very strong performance of the company in that area.

Luiz Fernando Rolla {BIO 1852035 <GO>}

Yes, of course the GSF, if I can say it so, was the villain of the semester. The expectation was that we would have something, 1.90. And we had just 0.82 in the quarter.

Marcus Vinicius de Castro Lobato

Yes. That was the worst recently as compared to last year, 0.83 right now and perhaps growing into -- by the end of the year. But we had a strong effect felt from the reduction of industrial consumption.

And it has been predicted that this should reach a very low point in August too. So moving towards the end of the year with a decline in consumption -- industrial consumption.

Luiz Fernando Rolla {BIO 1852035 <GO>}

Should this change substantially, or what happened in 2014 should be taken as a reference for 2015?

Marcus Vinicius de Castro Lobato

Well with the level of uncertainties we face right now, especially with the rain regime for this year, this can change a lot upwards or downwards.

But normally our projection is that what we saw this year is going to be repeated next year, 10% exposure, which is excellent.

Luiz Fernando Rolla {BIO 1852035 <GO>}

So we had in the quarter a profit of BRL29 million. That's not usual. I can't remember a quarter when we presented such a modest figure. But this was mostly a result of the Madeira plus GSF combined impact. What we can promise to you is we will double our work pace to improve it for next quarter.

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This is the profile of our consolidated debt profile now, total net debt BRL9.5 billion. Average tenor was reduced a little bit, having a reviewed loans we took in two recent years in view of the new economic and political context.

6.45% is the average cost of this debt. But indicators are even so at a very comfortable level.

At the close of the Third Quarter, we had 1.8%. This shows the solidity -- financial solidity of the group as a whole.

And we have BRL4 billion 2015 maturity -- maturing for 2015. And there should be no problem in extending that debt for further periods. And we expect a more predictable scene or scenario for 2015. And we can extend the tenor for that debt.

It should be 2018, 2019 originally. But depending on the financial market in 2015, we may expect a reduction in this average cost of the debt.

2015 still brings uncertainties. The market reflects those uncertainties. You probably read the forecast report. There are concerns about the economic context of 2015.

But in the electrical sector, our distribution, for example, will have a much better performance than in 2014, if we think that all the regulatory assets accumulated this year will be alleviated by the tariff increase expected for 2015.

Another aspect, opportunities for acquisitions and investments. It's important to stress the volume of investments for 2014, perhaps the best performance for the last 10 years, BRL3.6 billion by September. This is very substantial, much above -- BRL6.45 billion, rather, much above what we had in years before.

We should reach BRL4.3 billion for the year with highlights for the generation sector, with acquisitions of interest in Renova, Retiro Baixo. And additional interest in Santo Antonio.

The acquisitions program keeps going strong and very effective. We should close the year with a figure that is very substantial, very close to what we had planned. We should close at values around BRL4.5 billion in investments for the year.

That's very positive. And this will result in new cash flow -- fresh cash flow as new operations start up and dividends can be derived from these and also the already operating plants.

Investments -- you can see strong operations, trade strategies, what we have accumulated in the three quarters, much stronger than last year. And yes, far beyond what we had last year. Last year we included some de-investments.

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You can see the figures for this year should result in a reinforcement of this cash position, very comfortable for the group as a whole. All our companies' compound in the group have a very similar performance. And this brings Cemig to a very good position in terms of its expansion for its business portfolio.

We also see a very positive performance of our stock price, much above the market average. By the 12th of November, we had seen 17.3% PN Cemig shares and 20.2% of ON shares.

Taesá had a very good performance as compared to the previous year. Renova, because it's still under construction, they still have a lot to go, a lot to grow before them. But the BOVESPA index showed very good figures.

We are adding a lot of value to our shareholders, even more so because the dividend policy has been very strong with very attractive returns to our investors, which gives us all the conditions to broaden our depth, as we said before. But also seeking new opportunities for investments with the support of new entrants, new investors. And this is the future of Cemig, people supporting our policy for dividends.

The benefits deriving from this to our majority stockholder, the state of Minas Gerais, profited greatly from this.

These were the data and that was the information we wanted to bring to you more immediately. We have time -- plenty of time, rather, for questions and answers. And let's then proceed to it immediately. Let's move it back to the operator so that she can start off.

Questions And Answers

Operator

(Operator instructions.) Vinicius Canheu, Credit Suisse.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Good afternoon. I would like to raise issues that are facing Cemig, provisions in terms of BRL30 million. So 17.2% of the company. I would like to understand this. Can you break down these three components to us in millions? I would like to know if this is already limited by the contingencies tied to the acquisition of Andrade's stake. This is already included in the provision, or not? Do you still have room for this ahead of you?

A - Luiz Fernando Rolla {BIO 1852035 <GO>}

Leonardo should answer this question more technically to you.

A - Leonardo George de Magalhaes {BIO 21639277 <GO>}

Yes. Good afternoon. About the negative equity accounting of Santo Antonio, three conditions affected that, GSF, the Fitch -- the availability factor. And the third item has to do with the limit of liability of the buyer in terms of the delay of the works.

We can say that one-third of this value can be split into three by each one of these issues. If we split those -- divide that by three, that's a good representation of the situation.

But the provisions we made and whether it's limited or if there is a limiting factor, including the amounts that we feel we are entitled to and we claim for. And also the legal situation - - well, we are discussing that judicially. And there are some other administrative issues involved. But this is integral.

If we gain some favorable decision from the ANEEL or in the judicial discussion or within our discussion with Andrade with those 7% additional, this would be reversed to our balance.

So our maximum exposure is BRL350 million. But depending on the evolution of these three items and events, there may be a positive impact to the company.

A - Luiz Fernando Rolla {BIO 1852035 <GO>}

We notified Andrade Gutierrez about the contract that we signed for acquiring their stake in Santo Antonio SAAG. But nonetheless, effective of going into force of this we will be tied to the -- an implementation of those funds, as Leonardo said.

Operator

(Operator instructions.)

A - Luiz Fernando Rolla {BIO 1852035 <GO>}

And there being no more questions, we will then close this teleconference. And again, I would like to thank the presence of all of you. And to say of our confidence, our trust in the future prospects for Cemig.

As a function of this transition, of course our governor elect will change the face of the new -- of this majority stockholder. Future Governor Pimentel has already reiterated his respect for the company. And he says he is willing to introduce modifications according to his long term view.

And overall, he restated his trust in the plans Cemig has been implementing in recent years, especially regarding corporate governance, cash. And profitability in the long term.

That is a rather tranquilizing message to our investors. And of course, you know Cemig relies on our investors to go ahead with our expansion plans. And we believe that the new state administration will be perfectly aligned with us in also providing the best conditions for the investors to aid us in our expansion.

I thank you again. And I renew my confidence in the year's results. And this will be one of the best years ever of Cemig as for results. Thank you. And have a nice afternoon.

Operator

This webcast has been closed. We thank you for your participation. And wish you a very nice afternoon.

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