

Q1 2021 Earnings Call

Company Participants

- Marcelo Cardoso Malta, Chief Financial Officer
- Rafael Bosio, Investor Relations Manager

Other Participants

- Marcelo Sa
- Rafael Nagano

Presentation

Rafael Bosio

Good morning, everyone, and welcome to the ENGIE Brasil Energia's First Quarter '21 Earnings Result Video Conference. I am Rafael Bosio, the company's Investor Relations Manager (Technical Difficulty) interact with you without a mask and in safety. Each of us is in an individual room, respecting the protocols. People connected by the phone are in listen-only mode. Ensuing this when we open the question-and-answer session, participants will be able to send them either by phone, they will have priority in the pool as well as through the platform chat. It is worth remembering that this video conference is being recorded. We have made available on our website a results presentation and the earnings release with detailed analysis of the variation between the periods.

Before proceeding, I would like to clarify that all statements made during this video conference regarding the business outlook of the company should be treated as forecast depending on the country macroeconomic conditions, on the performance of the regulation of the electric sector and much more.

I'm here with Marcelo Malta, the Chief Financial Officer. Should journalists wish to ask questions, they can do so by email sending them to the company's press office.

I would now like to turn the floor over to Mr. Marcelo Malta, the company's CFO. You may proceed, sir. Malta, perhaps you're on mute.

Marcelo Cardoso Malta {BIO 21276941 <GO>}

I'm sorry. I had a problem with the connection. Good morning to all of you. Thank you for participating in our earnings results video conference for the first quarter '21. Mr. Sattamini, unfortunately, cannot participate. He asked for your forgiveness. He was called upon for an important meeting at the very last minute. So, Rafael and myself will make the presentation.

FINAL

Let us begin on Slide number 5, with our highlights and drivers for the quarter. We begin, therefore, with a positive effect that helped in our financial performance for the company. In this quarter, I highlight a greater generation of wind sources. We had significant enhancement in the wind conditions. And of course, this enabled us to have significant additional revenues. We had a reduction in the volume of energy purchases and this is due to our allocation strategy for energy. We also had a contribution of the energy transmission segment, thanks to the advance of the Gralha Azul and Novo Estado civil works.

Now, TAG significantly contributed towards our results this year and ensuing this, we will be commenting in more detail on the results of TAG.

We had an event that could be deemed as a non-recurring one-off event this quarter, which is the complement of those revenues that we set up in 2020 referring to the recovery of the GSF impacts in the past. Now, thanks to the update of calculations by the Electrical Energy Trade Board, we received an additional amount of BRL52 million.

We also had the impact of inflation on our energy sales contracts. Most of our contracts are indexed to the IPCA and we have a significant volume indexed to the general market price index.

Now, from the viewpoint of negative impacts, we had an expressive increase in our financial expenses due to the increase in inflationary indices, especially the general market price index, the IGPM, which is the index used for some of the concessions payable and this quarter, because of the inflationary pressure, we had a significant impact that as a consequence brought about a reduction in our net revenues. We also have a negative impact of the GSF in the quarter of '20. The GSF was approximately 1% and in this quarter, because of a poor hydrology it became exacerbated and represented 87% approximately. We also had a reduction in the amount of energy sold still due to the impacts of the pandemic. And finally, an increase in the cost of fuel in general, especially coal, because of the increase in the thermal electrical generation that we had during this quarter.

Now, to the right of the Slide on Page 5, we highlight the main contributors to increasing the EBITDA. In the comparison between quarters, it was almost 30%. Now, the main impacts were the energy purchases of BRL167 million. As mentioned, we did have a reduction in our energy account. The impact of the transmission margin, TAG, that contributed to our results with BRL72 million. The renegotiation of the hydrological risk that complement with additional revenues of BRL52 million. The variation of price and volume added BRL42 million to our results. The impact of the GSF, as mentioned previously, generating an additional cost of BRL48 million and the consumption of fuel of coal with a negative effect of BRL30 million.

Now, to speak about our net income. The major impact that we had on the variation of the general market price index on concessions payable ended up with an additional financial expense of BRL223 million contributing to this variation of 3.3% in our net income.

On Slide numbers 6, the following slide, we once again underscore the continuity of our actions to combat COVID-19. Because of the exacerbation of the crisis, we increased our participation on several fronts to be able to contribute at least towards helping in mitigating this risk during the pandemic, especially in regions surrounding our plants. And this, of course, had a positive effect, significantly reducing the number of employees that were contaminated by the virus.

We additionally had an evolution in the construction of the Campo Largo II Wind Complex. At present, we have almost 80 megawatts of the installed capacity in operation and we have other wind complexes that are beginning their operation. They're under test and we have a conclusion schedule to set up other units. And the expectation, of course, remains for the conclusion of the works in the third quarter of this year. We also during this quarter had our national Fitch Ratings, which is a AAA. This was confirmed and the international ratings in both foreign and local currency were maintained.

On Slide number 7, we're in the process of negotiating the sale of the Jorge Lacerda Thermoelectric Complex. We have signed an exclusivity contract with FRAM Capital. Now, this exclusivity extends for 120 days, which is the time that we deem necessary for the performing of the due diligence for a full assessment of this asset. Of course, negotiations are underway and we have perceived a stride on advancing these negotiations. In the short term, therefore, we should have clear signals in terms of the sale of this asset.

We also resumed the process for the sale of Pampa Sul, aligned with our decarbonization strategy. We have resorted to the market to assess potentially interested parties in acquiring this asset. Initially we had 12 companies that showed their interest and we are presently undergoing a selection process of these companies to continue on with the sales process. And we have perceived a significant progress in this process and we expect that until the end of the year or the first quarter of 2022, we will also have a clear indication regarding the sale of this specific asset.

On April 28th of this year, of course, just a few days ago, the Board approved the distribution of complementary dividends amounting to almost BRL610 million, representing BRL0.7471 per share.

During the quarter, we were acknowledged as being the best company in Latin America in the Environmental category. And of course this is an award that gives us a great deal of pride and the certainty that we are definitely on the right path when it comes to any issues relating to environmental impacts.

In the following slide, number 8, simply a comment. We're launching our 2020 sustainability report. This is an important tool to render accounts to society as a whole, at least to society that has access to this information. As we are aware, it follows the GRI guidelines and in ENGIE Brasil Energia, we guarantee the main components of this Global Reporting Initiative with the help of the Veritas Bureau. This year, we emphasize the tackling of the sanitary crisis; the strategic context, both of the present and the future;

and our corporate governance and social and environmental performance. Once again, should you wish to read this sustainability report, we have the link on the presentation.

I will now give the floor to Rafael, who will continue on with the presentation. And I will be back to speak in greater detail about our financial results. Rafael?

Rafael Bosio

Thank you, Malta. We go on to Slide number 10 please, where we begin to speak about our energy commercial strategy showing you an update of our energy balance. You can observe the level of energy availability, which includes an increase in availabilities in the years 2024 up to 2026. This thanks to the increase of our own resources by the coming into operation of the new park that will begin to be built in the coming months, which is the Santo Agostinho Wind Complex, we begin in 2023 with an increase in availability.

Formerly the energy balance reflected only the PPAs. We were selling energy from our portfolio. We now have this resource to compose the balance we had previously and here we have the effects of the coming into operation of Santo Agostinho Wind Complex beginning in 2023.

To the right of the slide, we show you the diversification of our contracts in the commercial field. We try not to concentrate the sell of energy in specific sectors. We have broad diversification to mitigate any sectoral risk and at the bottom, the availability year-after-year, our strategy of gradually contracting energy. And to give you an example, the year 2023, the blue bar with 43% represents what we had as available energy at the end of the year to '17 and through the years of percentage of on contract energy drops from 43% to 19% at the end of 2020. And of course, this will help us to mitigate our exposure to impacts that may arise from economy, the slowdown of the economy or effects that are unexpected, as happened with the pandemic in 2020. This constant evaluation protects our portfolio. We will have a greater availability of energy going forward in the year 2025, and we gradually close these positions.

We now go on to Slide number 11, where we continue speaking about the energy commercial strategy. It is important to underscore that we move forward capturing new clients, customers. We have 656 free consumers in the first quarter '21 compared to 619 in the first quarter '20. There was a drop in the volume contracted because of the pandemic. We're comparing this with a period in which the pandemic did not have a strong impact in the first quarter of 2020. So, we have maintained our market share in the free customers market and we have expanded our share in terms of number of customers to new data that we present this quarter. This is information that is proof of the purpose of the company of helping our customers in transition to low carbon economy, the certified emission reductions and the renewable energy certificates sold during this quarter.

We're expanding our range of products and offering a broader range to our customers to help them in this energy transition.

We will now go into the expansion session, where I would like to give you an update on the projects per se.

We go on to Slide number 13. The first project under construction and already in operation is the Campo Largo II Wind Complex. It came into operation under test at the end of 2020 and began commercial operations in the first quarter of this year. At the end of the first quarter, we already had 22% of our generators in operation, but you can see that in the second quarter, there has been an advance and we have gone to 34, wind turbines represent 40% of those that are under operation. The advance is quick.

Yesterday, we had a publication in the official union newspaper to release more wind turbines and this will take place as the construction comes to an end. As Malta mentioned, this will take place in the third quarter of 2021.

We go on to Page 14. Our next project, we speak about the Santo Agostinho Wind Complex, a new project. It is under implementation since the beginning of the year. We signed an agreement with Siemens Gamesa to supply wind turbines. The construction per se will begin at the end of June as remark, and this is a complex that will allow us to have 434 megawatts of additional installed capacity for non-conventional renewable energy, of course, broadening our share of the source in our portfolio.

On Slide 15, we speak about our transmission line projects. The first is the Gralha Azul Transmission System. This is in an advanced stage of construction with 83% of the total project completed in the first quarter, despite the challenges of the pandemic and problems with the environmental licensing of the project. However, the entry into commercial operation will be in the third quarter of this year, September 2021.

The second project Novo Estado Transmission of Energy. This is a project that we acquired last year in the secondary market with 15 transmission lines of 1,800 kilometers in the states of Para and Tocantins. Once again, this is also progressing. 54 -- 74% of the foundations of transmission line towers have been completed and we're going to comply with our coming into operation at the end of this year in December.

In the next slide, we present an update on the hydroelectric plants. In general, this is project that belongs to our controlling company, but we are interested in acquiring the share from the controller. This is a plant that is already under operation, and as you can see on the slide, it has operational excellence that is proven high availability of 99.5% during the first quarter of '21.

We go on to the next slide, where we present just a bird's-eye view of the projects under development. Presently, we have a variety of wind and solar projects that represent 1.5 gigawatts of installed capacity in the future, and they are awaiting of course commercial conditions to receive as Santo Agostinho has with its energy geared to the free contracting market, and they're awaiting approval for their implementation, a diversified ready portfolio simply awaiting market opportunities.

Malta, with this, I would like to return the floor to you to speak about the company's sound financial performance in the first quarter.

Marcelo Cardoso Malta {BIO 21276941 <GO>}

Thank you, Rafael. We're on Slide 20 at present, where we show you our financial performance. In the graph to the left, an increase in the return on equity and the return over invested capital. To the right, we highlight our performance in the last five years. Our investments during this period amounted to BRL19 billion with a very high leverage of 82%. Our proprietary installed capacity with a growth of approximately 24%. During this period, we had the acquisition of 32.5% stake in TAG. We entered into the transmission sector. We presently have 2,800 kilometers under construction.

Our EBITDA during the period had a growth of 74%, net income of growth of 66%, and dividends and interest on shareholders' capital totaled BRL9 billion. This is a summary of our sound financial performance in the last five years.

On Slide 21, we show you the net operating revenue evolution and I think that what I will remark here has already been mentioned at the beginning, perhaps what we can highlight is the impact of inflation on our sales contract. The increase in wind and thermoelectric generation because of the good wind condition and in thermoelectric with an aggravation of hydrological conditions during this quarter.

Now, when it comes to generation, this is -- in transmission, we had revenues of BRL681 million, thanks to the advance and the execution of Gralha Azul and Novo Estado civil works.

On Slide number 22, very -- in a very synthesized way, we show you the TAG results that ended the quarter with BRL537 million of net income. Our share is BRL165 million. The net income of TAG was high because of the use of the General Market Price Index on contracts. 60% of the TAG contracts are indexed to the IGPM, and basically this is what generated the significant increase in the TAG results.

And Slide number 22. We show you the EBITDA evolution. In the blue bars, we have the evolution of the generation activity with a growth of approximately 16% in the quarters that are being compared. And as I already mentioned in the previous slide, the operating revenues, we had other positive impacts, of course, in EBITDA that basically are the reduction and the sales volumes due to our strategy to allocate energy and something that has already been mentioned, the GSF complement because of past GSF periods that we had.

On the other hand, we also had negative impacts that resulted from a reduction in consumption caused by the pandemic. The GSF perhaps more exacerbated during this quarter and a greater consumption of coal because of the increase in thermoelectric generation. In terms of transmission, we had a margin of BRL143 million, and regarding TAG an increase in our stake on results of BRL72 million.

FINAL

In the following slide, the evolution of our net income, as already mentioned, a significant impact on our financial expenses mainly due to the variation of GSF on concessions to pay. We have BRL3 billion of concessions -- BRL223 million of concessions that are indexed to the IGPM. We also have sales contracts indexed to the IGPM of BRL4.5 billion and this generates a cash flow impact, but due to the use of the IGPM on these liabilities, the hedge of course will not be perfect and this is what is causing this impact on financial expenses in our results.

In the following Slide number 25, the balance of our debt. In 2021, we ended up with a debt of approximately BRL18,000 million. This is the gross debt and cash of BRL4,300 million and the net debt of somewhat more than BRL13,000 million.

We can see here that we are maintaining comfortable leverage levels in Slide number 26. The debt profile and composition, we see that there is a concentration of debts maturing in the next 24 months. And there is a highlight to the significant composition of these debts that mature and that are indexed to the IPCA, and a significant part also prefixed. The average term of our debt life in 6.4 years approximately. And to the right of the graph, we have the breakdown of our debt. The most expressive share indexed to the IPCA that has the hedge of our energy sales contract and the other indexers distributed between CDI, fixed parcel and TJLP. The nominal cost of our debt nowadays is of approximately 8.7%.

We have an increase that is due mainly to the advance of the IPCA generating an increase in the cost of debt.

On Slide number 27, we share with you our flow of investments in 2020. We had already invested approximately BRL4 billion and in 2021, the expectation is BRL3.6 billion now. We will invest more in Gralha Azul and Novo Estado. The works will be concluded until September of this year for Gralha Azul and until the end of the year for Novo Estado. In 2022 and 2023, we have investments that will concentrate on Santo Agostinho mainly.

And in Slide number 28, the background of our dividend payout. I would like to remind you that last year, we distributed BRL1.7[ph] million, a payout of 100% of our profit and the yield of 5.7%.

With this, therefore, I would like to end the presentation, and we are at your entire disposal to clarify any doubt that you may have.

Questions And Answers

Operator

(Question And Answer)

We do have a doubt coming from the telephone, I believe. Ladies and gentlemen, we will now go on to the question-and-answer session. (Operator Instructions) Our first question

comes from Rafael Nagano from Credit Suisse. You may proceed, sir.

Q - Rafael Nagano

Hey. Good day, Malta. Good day, Rafael. I'm referring to your energy balance for this quarter compared to previous quarters, and going until 2026. Now what is happening with the contracts which are the customer demands on the price level if you could remark on these? Thank you.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

In terms of the price levels in the short term, we have observed an increase in price. All of this perhaps motivated by the hydrological issues. We have been able to already capture this price increase, and as regards the sales volumes, were almost fully contracted for the two coming years -- the next two coming years. And because of this, we have been purchasing energy in the short term to be able to create products that we can sell in the medium term.

We do perceive a greater demand for energy already beginning in the year 2024 and we have closed some contracts in this direction. What we expect is that this will continue on. We see a resumption of consumption already in terms of energy and our expectation at present is quite positive.

A - Rafael Bosio

Malta, if you allow me to add to this. Rafael, it is good to observe in our energy balance on Slide, 33 and the attachments of the presentation where we present the average price sales until the year 2023. In the year 2023, if you compare this with the fourth quarter of 2020, you will see that the average of the contracted prices continues to increase. It was BRL194 and this average has increased to BRL202 on the average for the year 2023. We have been able to maintain the average price and increase it as well.

Q - Rafael Nagano

Very well. Thank you very much.

Operator

Thank you for the question, Rafael. Our next question comes from Marcelo Sa from Itau Bank. Your line is open. You may proceed, sir.

Q - Marcelo Sa {BIO 16454581 <GO>}

A good day to all of you. Thank you for the call. You have a pipeline with a significant number of projects and I would like to have an idea of which is the CapEx that you foresee for wind projects in your installed projects and others and which would be the peak of solar projects and the CapEx for that. Thank you very much.

A - Rafael Bosio

I believe that we have more updated information, and -- this is Rafael, Marcelo. As you can see through the CapEx that we announced for Santo Agostinho that there was a certain impact of the exchange rate and inflation. And because of the great demand of wind equipment because of the large number of projects that are being implemented in the country in 2020. Santo Agostinho has BRL5 million for installed megawatt. And of course, all of this is reflected in the price of energy sold. Year-after-year we try to maintain the margin and the return on projects.

We have several projects that are waiting for the right moment to begin their implementation. Santo Agostinho is a project that was successful, that is beginning now and we have begun contracting the next projects for the coming years. Our intention is to continue to deliver growth continuously through the renewable sources.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

And simply to complement what Rafael has just mentioned. It is our understanding that the wind projects at present are the most competitive and this increase in CapEx that can be clearly perceived process that there is enormous competition in the -- and we're trying to assess how we can set ourselves aside, set aside the prices of these auctions besides having a greater return that we demand from projects of this sort.

Now, the wind projects are less competitive than solar -- I'm sorry, the solar projects are even less competitive than the wind projects but we have been working arduously towards developing these projects so that we will end up becoming more competitive, especially in the free contracting market. Our portfolio for our project has been reduced throughout the last few years because of the projects that we have acquired and are working on. And in the market, we are seeking interesting projects that we believe could have a good risk-return ratio one that we will deem to be adequate and this to be able to recompose and have a greater volume of projects in our pipeline.

Q - Marcelo Sa {BIO 16454581 <GO>}

Okay, that's very clear. Thank you. And if you allow me, the idea of selling a large part of the energy of a project before you start to build it, now would it make sense to develop on a -- develop a project for five years in the long term, medium term, which will be the balance as you attempt to develop new projects?

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Our strategy, of course, remains the same. And one of the conditions to make our project feasible is expressive contracts, at least for the medium term. What we have observed is a flood of projects that are being developed to capture the discount and projects approved until February of the coming year will guarantee this discount. And because of this, this significant volume of projects allow us to perceive a trend for the reduction of price. And of course, we have to think if this makes sense to make feasible projects and approve some projects until the year 2021 to remain with low contracting or lack of contracting. Because of this large volume of projects, there will be a trend towards a price reduction.

We will perhaps wait for the more appropriate moment to contract this energy and to guarantee a desirable return on our projects. This is simply an initial evaluation that we're carrying out. We're maturing on this. Our controlling company is quite restrictive when it comes to non-contracted projects. We have been discussing this scenario at depth with them and in the coming months, we should have a more precise evaluation to see if it makes sense or not to change our strategy.

Q - Marcelo Sa {BIO 16454581 <GO>}

Very good. I understand. Thank you very much.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Thank you.

Operator

(Operator Instructions) I will now give the floor to Rafael who will respond to some of the questions from the web.

A - Rafael Bosio

Very well. We have several questions via platform. I will select a few of them that are connected and we can remark on them more generally. The first question comes from an investor Mauricio Hennerman[ph] who asks about what is happening with the hydrological levels, the level of the reservoirs. And I'm summarizing two questions in one question about the hydrological risk because of this.

I think it is public knowledge that this year we're facing a rather challenging hydrological situation. In the first quarter of 2020, the GSF was approximately 85% to 87%. For this year and last year, we had secondary energy, a surplus of energy of about 5%. With this year-on-year comparison, this is something that should be highlighted on our performance. We had a very good performance. If we see how much more challenging hydrology is this year and to reinforce what Malta mentioned, this because of our portfolio management, the reservoirs had reached a level of 35% at the end of the third quarter 2020. And at the end of the first quarter 2020, these reservoirs had reached 55% in the Southeast. It shows you how challenging hydrology has become and how we have been able to mitigate the risks and safeguard the company's results during this period.

Malta, do you have a comment?

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Yes. I would like to underscore that the hydrology is one of the worst in the historical series. It truly is a very serious situation and this, of course, poses a huge challenge when it comes to our portfolio management. We have the Jorge Lacerda management with significant hedging against hydrological impacts and additionally to this, we have a strategy of allowing the part of our energy to be on contracted and as a management process depending on the GSF risk, we will also resort to the market to buy energy.

What we expect for the coming months is that the GSF will become exacerbated further increasing the challenge of our staff working day after day and managing our portfolio. As Rafael mentioned, we have vast experience, we have the ability to work with projections that are very close to reality. And this allows us to have greater tranquility that we will be able to continue adequately with our management.

A - Rafael Bosio

The next question also refers to Jorge Lacerda. They have asked for an update in the sales process which we already remarked on. We're undergoing a period of exclusivity with a potential buyer and investor. This process is underway and we're awaiting the close of this process to see what will happen. And the question refers to if we decide to sell or decommission Jorge Lacerda, how much of this energy has been replaced by wind energy in the last few years?

I will try to remember and I can mention that in the last years we -- in the last five years, only 700 megawatts in installed capacity, wind capacity with Umburanas and Campo Largo Wind Complex and we're now implemented Campo Largo II that will add another 360 megawatts. So we're adding more than the installed capacity of Jorge Lacerda in the last few years in wind capacity and we continue to move forward with the construction of the Santo Agostinho Wind Complex.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Simply to complement Rafael, in terms of the sales process, FRAM Capital had assessed Jorge Lacerda project three years ago when we began the selling process, and they had even presented a proposal. We decided that selling the asset did not make sense considering the risk-return ratio. Now, despite the decarbonization strategy, it doesn't mean we're going to sell the asset at any price. When we announced at the end of last year that we would set up a working group to assess the value of Jorge Lacerda, we did emphasize that one of the possibilities would be to decommission the plant in a phased way until 2025 and FRAM decided to reinitiate negotiations with us. And we're working jointly to mitigate some significant risks.

The main risk was an eventual contingency of the mining companies, The problem there is environmental and it needs to be addressed. We're convinced that the risk would not be ours, of course, considering that it is connected exclusively to the mining activity. But despite this, there was the assessment that this risk could affect ENGIE Brasil Energia as a company as a largest generating company and that, perhaps we could bear this entire risk mentioned by the mining companies and assessed by FRAM Capital. So the process has progressed. The negotiations are doing very well. Jointly we have been able to mitigate this environmental risk and this leads to the expectation that it will be possible that the business will come about.

As regards, the substitution of this generation with new investment, Rafael has already explained what will happen and the generation of this plant has a hedge for the GSF and we have re-evaluated our risk management strategy. And what we have done is to foresee a larger part of uncontracted energy. Of course, it is possible that we will

continue to acquire energy if the asset is sold for a very short term, and this will guarantee the hedge for a longer time.

A - Rafael Bosio

Thank you, Malta. I have one question that I can respond to very quickly. The question by Andre[ph] who refers to the Gralha Azul transmission lines. If we have overcome the legal issues that impeded the conclusion of this plant? To remind you during the first quarter, there was a second injunction suspending the construction of some of the pieces of the transmission line. Despite all of this, the injunction was canceled even before it came into effect.

It was based on a thesis that was very similar to the first injunction that we've received at the end of 2020, canceled by the Supreme Court, the SCJ. So far, we have no other public civil action referring to the implementation of the transmission lines in Parana, and we reaffirm our projection and expectation that will -- it will come into operation in September of 2021.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

And I would like to highlight, Rafael, that this second injunction was canceled very quickly and did not lead to a standstill in the schedule of the works. We have 83% of the work concluded so far, and we do not expect in the short term or until the conclusion of these works that there will be time for a new request for injunction. We are quite optimistic that until the conclusion of the works, we will not have any other legal instrument that will prevent this work, and the environmental licensing of this project was done within very stringent standards and we were not satisfied with several issues. We did not simply comply with legal conditions. We attempted to go beyond.

A - Rafael Bosio

I will now go into questions about indebtedness. There is a question from Santiago Santos, and the second question from Jerome Armeda[ph]. Santiago asks, with an outlook of greater indebtedness, this is such as there is a risk in payout or reduction in payout. And Jerome[ph] says that 63% of debt is pegged to inflation, which is the outlook of the company on the increase in inflation and which is our stance?

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

We have a very balanced debt. We have a net debt to EBITDA ratio of 1.9x. And of course, this opens up a great deal of room to invest new investment and this is what we have done. We have been able to finance EBIT to leverage the projects as well. Now, if we consider Santo Agostinho and other projects of the same magnitude during the coming years, we do not foresee a reduction of payout. Evidently year-after-year, we carefully assess the strategy to define the payout, but in the short term, it is our understanding that there will not be a significant reduction of payout.

We have a profit reserve that is significant and, of course, this could be paid out at any point in time. This is not part of our short-term strategy at present, but it is important to highlight that we do have room to increase the payout if this becomes interesting for us.

Our main commitment, however, is to continue on with the projects that we foresee and increase the leveraging to have a more adequate capital structure.

A - Rafael Bosio

Malta, regarding the second question, I begin with a remark referring to the indexation of the debt.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

I can respond to this, Rafael. As mentioned, almost our full debt or our energy sales contracts are indexed to the IPCA and we can hedge the entire cash flow of these debt with the IPCA without any problem. We do not have any risk of increasing the inflationary levels because of this natural hedge that we're working with.

A - Rafael Bosio

And this takes us to the next question that refers to the concessions payable. Dan (inaudible) asks us to speak a bit more about this impact and which is the impact of the IGPM that increased our financial expenses.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Concessions payable arise from a process of competition that we had in the past, Cana Brava, Ponte de Pedra, and Sao Salvador, well, mainly -- and the concept in the past was that the person who won the auctions or the companies that presented the greater value payable for the concession.

And at that time, the auction rules would set forth that some concessions had to be indexed to the general market price index and others to the IPCA. As this was very common in the past to contract energy or sell energy index to the IGPM, we always had a cash flow hedge to be able to bear the variation of the IGPM. As I mentioned formerly, this is a hedge for the cash flow and as the sales contracts or the IGPM are reduced, we also generate a inefficiency in the balance hedge now because of this recent behavior of the IGPM. And we should consider that we have a balance in our concessions payable, the IGPM on this balance will generate a significant impact on our financial expenses.

At present, it is not very common to sell energy indexed to the IGPM and because of this, we are assessing the possibility of requesting from ANEEL that they change our indexator. We're working on projections to see if this is the right moment to carry out this change that this has been foreseen in the ANEEL rules. We did this in the past with no restriction whatsoever from ANEEL. And at this point in time, we're moving forward in this analysis and in the short term, we should have a better definition on whether to request this change of indexator or not.

A - Rafael Bosio

Thank you, Malta. Very good. We've gone a bit beyond our time. We have two more questions regarding the company's strategy and transmission. If we're going to persist and continue to expand our presence in this segment. Malta?

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Yes. We entered the transmission activity, of course, thinking about growth and being an important player. Unfortunately, we have not been very competitive in the auctions. We're assessing M&A opportunities as we did with Novo Estado and the ambition is to grow 1,000 kilometers in transmission lines per year. This, of course, is a challenge that this ambition is still in place, and we have been acting effectively in the market to identify opportunities. Yes, we're extremely interested in growing in the transmission sector.

A - Rafael Bosio

Very well. With this, we are coming to the end of our question-and-answer session. We do have some questions pending in the chat, but because of the time constraint, I think we will stop. I will ask the operator if we have any further questions. Once again, the Investor Relations team is at your entire disposal to respond the questions that were not answered during the call. I ask the operator, if there are any further questions coming from the telephone.

Operator

We have no further questions. And at this point, we would like to conclude the question-and-answer session. We return the floor to the speakers for their closing remarks.

A - Marcelo Cardoso Malta {BIO 21276941 <GO>}

Thank you very much for one more call. Of course, it is always very important to have this exchange with you. As Rafael mentioned, our IR department is always at your disposal to offer all the clarifications that might be necessary. Should you have additional questions regarding this quarter, please contact our IR team. They will be ready to respond to all of your questions.

Thank you. Have a good day and until the next call, thank you, everybody.

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.