

Y 2019 Earnings Call

Company Participants

- Alexandre Nogueira Ferreira, Regulatory Affairs and Strategy Director
- Mauricio Perez Botelho, Chief Financial Officer, Investor Relations Director & Member of Executive Board
- Ricardo Perez Botelho, Deputy Chairman of Directors, Member of Executive Board & Director

Other Participants

- Analyst
- Marcelo Sa
- Maria Carolina Carneiro

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to our Conference Call of the Earnings Release of the Fourth Quarter of 2019 of Energisa. The audio for this conference is being broadcast simultaneously through the Internet in the website ir.energisa.com.br where you can also find the presentation available for download. We'd like to inform that during the company's presentation, all participants will be only at listen mode. Then we are going to start the Q&A session and further instructions will be then given. (Operator Instructions)

We'd also like to inform that the conference call will be held in Portuguese with the company's management and for -- the English conference will be simultaneously translated.

I would also like to clarify that forward-looking statements that are subject to known and unknown risks and uncertainties that could cause the company's actual results to differ materially from those in the forward-looking statements. Such statements speak only as of the date they are made, and the company, Energisa, is under no obligation to update them in light of new information or future developments, and this should be always taken into consideration. Investors should understand that general economic conditions, industry conditions and other operating factors may impact the future results of the company, leading to results that materially differ from those expressed in forward-looking statements.

I will now turn the conference to Mauricio Botelho, who will start the presentation. Mr.Botelho, you are now on the floor.

Mauricio Perez Botelho {BIO 2105889 <GO>}

Good afternoon, everyone. Thank you very much. I would like to start by thanking your participation in our teleconference of the fourth quarter '19. We have here Ricardo Botelho, President of Energisa; Gioreli de Souza, VP of Distribution; Alexandre Ferreira, VP of Regulation -- Finance Corporation; and finally, our Investor Relations team. I'm going to share with you some slides, and then we are going to open for questions and answers.

Let me remind you that similarly to previous quarters, we are going to present the results of ERO and EAC considering 2018. But the financial part, where we have pro forma balance, we are not going to consider the acquisition of these companies presenting our results. It not only acquired the distributors, but had already been part of the legacy.

Slide 3, let me remind you of the positive non-cash effect that happened in fourth quarter '18 of BRL1.2 billion, referring to the results that have been accounted for in the combination of businesses related to acquisition of Energisa Rondonia and Energisa Acre, which ends up distorting some of the comparisons.

Adjusted EBITDA totaled BRL1,056 million in the quarter and BRL3,840 million in 2019, showing decrease of 44% in the quarter and 6% in the year according to accounting method. If we don't consider the recently acquired company, adjusted EBITDA has reached BRL1,078 million in the quarter and BRL3,968 million in the year-to-date '19, which means 58% increase in the quarter and 38% increase in the year.

Profit reached BRL466 million in the fourth quarter '19 and BRL1,177 million in 2019, with increase of 639% and 107%, respectively.

I would also like, for you, exercise some important event after the closure of the quarter. First of all, the presentation of dividends BRLO.32 per unit, which means BRL116.1 million, which are going to be paid as of April 3rd.

Finally, in mid-February, we presented our CapEx projections and forecast that we are going to share with you later.

Slide 4 now. We can see the distributors market. Sales increased 4.1% in the quarter or 1.7 percentage point above national consumption level. In 2019, the growth was 4.2% against 1.4% of growth in Brazil. Since 2009, consumption progression in the concession areas have been at about 2.2 percentage point above the national average. The growth of the fourth quarter '19 is primarily due to the performance at household customers, which increased 6.7% in the quarter and commercial applications, which grew 4.2%, both influenced by high temperature levels and also calendar effect.

I'd also like to highlight Energisa Mato Grosso do Sul, which had growth of 8.4% in the quarter, and household customers grew 11.9% or 58 gigawatts hour. Another important highlight was Energisa Sul-Sudeste reaching the second best performance in the group, 6.9% increase, also influenced primarily by the household segment.

FINAL

Now, we can look to Slide 5. And here, we can see once again our efforts to deal with low-income population between 2018 and 2019. There was increase of 170,000 new customers registered as low-income customers, primarily for Energisa Rondonia, Energisa Acre amounting to 27% of this growth.

Now, Slide 6. We can see on the left, our total electrical losses. There was a decrease in total loss, reaching 13.48% as injected energy, 0.12 percentage point below September '19 and 0.09 percentage points below December '18. This equation shows our consistence in our activities against fraud and theft of energy. If we exclude Energisa Rondonia and Energisa Acre, total electrical losses represent 11.52% of our amount of energy or 0.27 percentage point below the regulatory average.

And the total market growth maintained its improvement journey, presenting a reduction of 0.06 percentage point over September '19 and 0.50 percentage point compared to December '18, once again, closing the year within the regulation or the regulatory limit. There is still a number of challenges to be dealt with, and we are going to keep on working to maintain risk-mitigated deal versus regulatory goal.

Another highlight was, Energisa Tocantins, there's a reduction of 0.485 and 0.64 percentage point over September '19 and December '18, respectively, or 1.37 percentage point below the regulatory limit.

Energisa Paraiba, which is currently above the regulatory goal, this is due to the increase in solidifying connections and types of energy. We've applied a number of actions defined against that in 2019, which meant an increase of 37% over what we had in 2018. Regardless, it was not enough to compensate what has been lost throughout the year. But in 2020, we are going to reinforce our action to correct this deviation.

Slide 7, we are going to talk about quality. Highlighting here, Energisa Rondonia -- so except Energisa Rondonia, all distributors were below the quality regulatory limits.

In relation to FEC or tariff, Energisa Minas Gerais and Tocantins and Sul-Sudeste, which is there at historical levels. Excluding the recently acquired distributors, Energisa Tocantins presented its second best evolution in the group in DEC side with a reduction of 1.54 hours compared over December '18, reaching 21.55 hours. Another highlight for industry success rating was the second best performance in Sergipe in FEC with a reduction of 1.52 times.

For Acre, Rondonia in the year of 2019, we've been training our own team (inaudible) focusing on quality. And we've made major investments in these two concessions, and this is going to help us recover quality in provision of energy and services.

Now, let's move on to Slide 9 -- 8, excuse me. Here, we're going to go into financial highlights. The explanations of distributors here are excluding the results of Energisa Rondonia and Energisa Acre.

In PMSO pro forma, we had an increase of 6.8% in the quarter. In the year, the total amount was 2.1% above '18 or half of the inflation rate in the period. Part of the increase in the quarter may be explained by the line others as a result of cost provided by Alsol, which is a turnkey project for customers. It amounted to BRL48.3 million in 2018. In the fourth quarter, there was no correspondence to the services.

There is a counter-back in revenue with a positive effect over EBITDA. If we didn't consider this effect, PMSO in the quarter would be aligned with the fourth quarter '18 and also the year 2019.

Slide 9. Now, we can see a brief analysis of PMSO of Rondonia and Acre in the quarter and in the year. We can see some non-recurring effects. These exclusions have really made the whole performance to be more aligned with the activity of the companies adopting very important actions that are going to be repeated during 2020.

For these companies, these non-recurring events refer to disconnections and also termination of some employment. For example, some retirement plans, some voluntary rescission. Then we had to pay some labor cost as well, especially with headcount. There are also some additional services, consulting services and some related to extraordinary tax and legal consulting. Based on the charts, you can see a relevant impact of these events, BRL136 million spent in non-recurring events in the year, whereas for Acre, it was BRL33 million.

Now, we can see on Slide 10. On the left, we can see the whole provision of pro forma consolidated EBITDA of the fourth quarter. On the right, we have accounting consolidated EBITDA. The adjusted EBITDA, if we don't -- we already -- if we exclude Rondonia and Acre, it was BRL1.1 billion in the fourth quarter '19 and about BRL4 billion over '19, amounting to 58% in the quarter, 138% increase over the year.

I also highlight non-recurring effects. If properly excluded, the EBITDA of the quarter would have been increased by 20% as a result of the increase of BRL148 million in Parcel B of distributors. In 2019, this improvement would have been 22%, with an increase of Parcel B of BRL759 million.

(Technical Difficulty) If I may ask you to hold, please. We seem to have a technical issue here. If you can please hold, I would appreciate that. Thank you. We still have a problem here in our webcast audio. Please hold. Well, it seems that we are back. I apologize for the inconvenience, and I hope nobody has lost anything important from Slide 10. Should you need any additional clarification, we can go over that during the Q&A session.

Slide 11. On the left, we can see significant progression of pro forma consolidated net profit with an increase of 639%. With the non-recurring effects in this quarter, and we mentioned that in the annex of the presentation, there will be bonus of subscription related with the severance and issuance of debentures revenues in Energisa amounting to BRL144 million without cash effect as opposed to BRL165 million in the fourth quarter '18. Pro forma net profit amounted to BRL385 million or 73% over the fourth quarter '18. If we exclude this effect of the market and the amount of the subscription bonus, we're

going to total BRL1.2 billion or 95% over what had been observed in 2018 amounting to BRL1.4 billion.

Now, we have Slide 12 to cover where we talk about indebtedness. Total consolidated amounted to BRL13.7 billion, including BRL1.1 billion referring to the issue of debentures and the debt associated with retirement bonus amounting to BRL628 million. Once executed the bonus, we are going to have the effect of a reduction of approximately BRL1.7 billion in net debt amounting to 0.5 times the net debt indicated by EBITDA.

The covenant indicator reached 3.6 times in the end of the year. It's also affected by the combination of the businesses from 2018, which would amount to BRL1.2 billion. But we are operating within the limits and all the factors that have been negotiated, and it brings it between 4.5 times and 5 times during 2019.

Let's talk about investments in Slide 13. It grew to BRL3.2 billion at the end of the year or 60% increase over '18 and BRL2.7 billion related to the segment of distribution, meaning an increase of 52% period-over-period. In the area of transmission, we invested approximately BRL366 million in 2019. The trans projects were Para I and II and Goias I, in which we invested BRL350 million in 2019 and BRL172 million in 2018.

Slide 14, we can see investment planned for 2020 as we presented in February in our reference form. The estimates of investments amount to BRL3 billion, 85% of which will be concentrated in our group distributors, 10% for energy transmission and 4% at Alsol. Rondonia and Acre will together receive BRL832 million during the year. And Rondonia will be the distributor that will receive most of the investments, considering all the categories we presented. In terms of electric assets, we are going to still make relevant investments just second to Mato Grosso.

Slide 15, we are going to talk about transmission. The projects that were purchased during auction in April 2017, Energisa Goias I, Energisa Para I, they were started in September and October 2018, respectively, and they have advanced Goias who reached 99% and Para 183%. So based on these figures, we can anticipate that it will be higher than initially expected. Energisa Goias is coming close to its commissioning test phase. And soon, we're going to have operation to fund the commercial operation of the facility.

We have been negotiating with many land owners. Hundreds have been impacted. That coming to the end of it, concession now belong four in Tocantins, whose contract is being signed by 2024. Energisa Para II, which was a lot obtained in June 2018 through an auction, will be operation -- the construction operation started in June 2019, and we've already covered 30% interest lot.

Energisa Tocantins, which was obtained in December '18, we had a basic project confirmed in July 2019. And part of the initial design for requesting a previous permit has also been provided through the Environmental Agency in July 2019. In this project, we've already started negotiation with land owners that are impacted by the operation.

Bringing together these four projects, it means RAP of approximately BRL192 million and a CapEx of BRL1.5 billion.

Well, it closes my presentation. And now we would like to open for our questions. And once again, I apologize for having lost part of the audio conference for a few minutes. Thank you.

Questions And Answers

Operator

(Question And Answer)

Well, thank you very much. We are now going to start our Q&A session. (Operator Instructions) First question comes from Carolina Carneiro from Credit Suisse. Please proceed.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Good afternoon, everyone. Thank you very much for this call. I have two questions. The first one concerns regulatory issues. Some time ago, ANEEL provided the final (inaudible) searching some questions from ANEEL's own area and one specific area. And there, it seems -- it changed the initial interpretation where there would be an opportunity to have recession in 2019. But later, ANEEL had a different kind of interpretation. And the companies are trying to change and revert this decision. I would like to hear your take on the specific document and what kind of implications it may have over your extraordinary reconsideration request that you've made and also the retrospective analysis that it would have in the quarter?

Once again, Alsol showed a growth within its segment, gaining relevance. It's a small business concerning your group portfolio. But what can we expect for 2020 in this segment? Do you really believe that the increasing trend, quite relevant in 2019, will remain so?

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

The first question, I'm going to ask Alexandre to have the first, and then Ricardo is going to answer the second one.

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

Thank you. Good afternoon, everyone. Concerning what ANEEL presented in its position, we are in contact with them. A number of report is presented -- reported to the our committee presented that when reviewing the taxes, and they haven't analyzed some of the arguments that we presented in our appeal. An opinion of the public authorities is non-binding. Therefore, we believe that the whole process of analysis of the appeal is ongoing, including all the specific consideration that should be made.

Let me now turn it to Ricardo to make his comments.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

Good afternoon, Carolina. Concerning Alsol and our activities in the business, in our Alsol business, throughout 2019, it was based on increase of revenue from turnkey projects. These are projects that are sold as a solar plant operations. This is a model that we discontinued last year, because it was just one single revenue imputed, and then you get paid over the construction by third parties. And you end up having just a small amount of OEM revenue for the future, which is not very relevant. So we changed the business model for 2020, and we changed it last year to run a model in which you explore shared generation and remote consumption -- high remote consumption. In this new model, you generate revenue from (inaudible) project, fewer number of consumers. And that is a model that has gained more momentum.

We've managed to have three projects in full operations, selling them to customers, to clients. And it has a recurring revenue flow. So what we're going to do from now on is to invest further in this model of distributed remote share, distributed generation, adding additional services such as battery, energy efficiency and some added value services.

Our perspective is still quite good. There hasn't been a difference in regulatory affairs. Because of the potential technologies that our company has and its portfolio of clients, it's still quite capable of experiencing significant growth in the future.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Thank you very much for your answers. Very clear.

Operator

Our next question comes from Marcelo Sa from Banco Itau. Please proceed.

Q - Marcelo Sa {BIO 16454581 <GO>}

Hi. Thank you for this call. I would like to hear about some strategic points of the company, because you were more focused on buying distribution assets. But now the assets available, maybe they have a different nature and it wouldn't be that the company wouldn't be as competitive as I may believe. Now thinking about the scenarios, would it make sense to go stronger into generation? We've recently seen a movement of combining assets with ETT and diversifying portfolio. Would it make sense in your company to acquire a company and go somewhat stronger in that segment? Thank you.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

In the short-term, we don't see that movement into generation, except for GP, which we've been working with often. And we do have some projects in our pipeline, a project in Bahia, Sao Paulo in Paraiba as well, but the prices in auctions are not very attractive. So probably you'll have to bring together free market in auction. And the free market still has very short reference terms, very short deadline. So we have to have a mix and match of

projects and contracts, which end up bringing from. But we don't think we are not -- get away from the competition in distribution really.

Q - Marcelo Sa {BIO 16454581 <GO>}

If I can ask you second question concerning the discussion of (inaudible) tax rate, can you please update the discussions that you've been having with now the regulatory agencies? Do you think they're going to come to any conclusion soon?

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

This is Alexandre speaking. Good afternoon, Marcelo. It's something that has brought to the attention of the regulatory agency. We've been monitoring it closely, and we believe that the regulatory agency will have a reasonable position. This is something we've been monitoring very closely, but there is no update yet.

Q - Marcelo Sa {BIO 16454581 <GO>}

Thank you.

Operator

The next question comes from (inaudible). Please proceed.

Q - Analyst

Hi. Good afternoon. Great presentation. Thank you. I'm going to ask about financial leverage, because your net debt and EBITDA and the evolution have been increased over the years. People really feel comfortable with that figure. How far would it go? And do you have any plan to reduce that debt in relation to your EBITDA?

A - Mauricio Perez Botelho {BIO 2105889 <GO>}

Well, with the decrease of the interest rate in Brazil, energy distribution companies and companies in general have been operating at higher covenant levels. We've reviewed the covenants of all contracts to 4.5 times, and then it went down to 4.25 times and then 4 times. I think we can operate close to 4 at lower levels. But should there be any change in the scenario in the interest rate? We'll have to adjust that.

Then there's another important point here, as I pointed out in my presentation, which is a potential conversion of the shares of BNDES. It's by August 22 that we have a deadline of the bonus, and that would mean 0.5 in leverage. If we are close to 3.6 on December 31st, we have to deduct 0.5.

Q - Analyst

Great. Thank you.

Operator

(Operator Instructions) If there are no further questions, I would like now to turn it over to Ricardo Botelho for his closing remarks. Please proceed, sir.

A - Ricardo Perez Botelho {BIO 2105867 <GO>}

Well, thank you. It's been a pleasure to have you here in our earnings release conference call for 2019 where we presented important achievements as a group. I would like to share with you how glad we are to have celebrated 115 years of Energisa in February this year, our 115th anniversary. And for all that time, we've had a team of excellence to help in our journey of growth, not only in the business of distribution, but also with a broader business of electrical energy services, also working towards sustainable sources of energy and managing all our companies.

Our main focus will always be presenting the best services to our clients. In 2019, we amounted to 7.8 million consumers. And they are a sort of inspiration to our company for continuously developing our work in 11 Brazilian states. And we are very proud to share with our market our achievement in 2019. We've presented a significant growth in our market in volumes of distributed energy, as Mauricio pointed out. We also had increasing profitability in our companies, always working with an ethical, social and environmental perspective in our role in the productive chain.

We've renewed the concession of energy they'll consume, being absolutely sure that we could provide services of excellence to our customers. For the past three years, this company has gained a specific highlight in the region in the company of central, west and north of Brazil. We strongly invested in our concessions. We've added BRL11 billion in investments in modernizing our infrastructure for the past five years, all focusing on innovative solutions centered in our customers in all regions where we work.

And on top of that, we've been working very hard throughout 2019 in restructuring and integrating distributors, Rondonia and Acre, acquired in the end of '18. Investments in the first two years of acquisition of Energisa includes two companies will be higher than anything that we've invested in six -- that has been invested in six years of state-owned and controlled. We view the optimal capital allocation methodology, and we've been directing investments to improve the quality of the provided services, which will bring benefits for the economy of the state and for consumers.

I'd like to conclude our meeting this afternoon by telling a little bit about our moment of really concern in global economy because of the dissemination of COVID-19. We are paying close attention to its dissemination, and we have a work group to preserve as much as possible the quality of our staff and maintaining the quality of operation within the quality standards, continuation of the operations. We've maintained -- now we have new hygiene routines for our service providers and team. We also have a protocol for quarantine, if required. And we've canceled national and international trips except in situations that are going to be analyzed individually. We've also decided to postpone larger meetings and events and conferences that require traveling. We are going to rely on the technology that we currently have in-house, mainly video conference meetings whenever possible.

FINAL

Finally, we are also expanding that kind of guidance to our clients, encouraging them to prioritize new digital channels to interact so that we have a few people coming to our branches. We've also been paying close attention to our end markets because of the expectations of decrease in global economy and the unpredictability of the impact it will have on people's life. Despite this really uncertain outlook, our activities as a company have not been inferior. And we haven't identified, as we've seen in our earnings release from 2019, any significant impact that would modify our business forecast and assumptions and measurements of assets and liabilities.

We are really confident that the authorities are doing everything they can to prevent the expansion of the virus all over the world. And we are here willing also to fight against the dissemination of the disease.

We are going to carry on with our projects in 2020 with investment amounting to BRL3 billion as provided before. And we have over 15,000 direct employees to help us execute this project, focused on sustainable growth and generation of value to all our stakeholders. Thank you once again for being here with us this afternoon, and we wish you a great afternoon. Thank you.

Operator

Thank you very much. The conference call is now concluded. Please disconnect now.

Bloomberg Transcript

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.