Q4 2012 Earnings Call

Company Participants

- Lindolfo Zimmer, Chief Executive Officer
- Luiz Eduardo da Veiga Sebastiani, Chief Financial, Investor Relations and Control of Holdings Officer

Other Participants

- Lilyanna Yang, Analyst
- Oswaldo Telles, Analyst
- Unidentified Participant

Presentation

Operator

Welcome to COPEL's Conference Call for the Results of 2012. All participants will be in a listen only mode during the Company's presentation. Later, we will conduct a question-and-answer session, when further instructions to participate will be given. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements relative to COPEL's business, projections and operating and financial goals are based on the beliefs and assumptions of COPEL's management and on information currently available to the company.

Forward-looking statements are not guarantees of success and involve risks, uncertainties and assumptions, because as they relate to future events and therefore, it depends on the circumstances that may or may not occur in the future. Investors should understand the general economic conditions, the industry conditions and the other operating factors could also affect the future results of COPEL and could cause results to differ materially from those expressed in such forward-looking statements.

This conference call is attended by Mr. Lindolfo Zimmer, CEO of COPEL; and Luiz da Veiga Sebastiani, CFO and IRO. The presentation will be made by COPEL's management and maybe forward through the company's website at www.copel.com/ri.

We now turn the floor to Mr. Lindolfo Zimmer. Mr. Zimmer, you may go ahead.

Lindolfo Zimmer {BIO 2132989 <GO>}

Good afternoon to all and welcome to COPEL's 2012 results conference call. Before anything, I am delighted to introduce our new CFO and IRO, Mr. Luiz Eduardo Sebastiani. Call is given a twofold dimension: to continue and improve a close relationship with the capital market. And to align the market view with the management's view regarding our short, medium and long term. Mr. Sebastiani is an economist, who graduated from the Federal University of Parana

and with the Masters degree in Economic Theory from the State University of Campinas. Among other previous positions, he was the Secretary of Finance for 6 years and was recently the Chief of Staff of the State Government of Parana

and Fiscal Advisor to the Parana sanitation company, Sanepar, into Companhia Paranaense de Energia, COPEL.

I would also like to mention two other important changes in the company management. To take over the office for the Environment and Corporate Citizenship, we appointed Engineer, Jonel Nazareno Iurk, who holds a Masters Degree in Social Science and a specialization in environmental engineering.

Up until recently, he was a secretary for the Environment of Parana. Soon, Engineer, Vlademir Daleffe will take over as Distribution Officer. He specialized in Energy Utilities Management having graduated from the Federal Technological University of Parana. Chief, Daleffe has been with COPEL for many years and has served as COPEL's Distribution Officer previously. These changes of key for our management and will drive the improvements that we want to bring about.

Well then, 2012 was an intense year for the Brazil in electric sector, full of novelties. The approval of Law 12,783/2013, which rules on the extension of confessions engaged a good deal of our attention. COPEL's management based on the rationale to maximize the net preference value of its cash flows, chose to accept the government agencies proposal to anticipate the extension of the transmission assets in agreement to 060/2001, given our strategy to work as a consolidating agent in the transmission business in Brazil and the resulting need to capture economies of scale and optimize the use of our teams of specialists in this area.

As of January of this year, the Annual Permitted Revenue of the extended agreement will be R$ 116 million, down from 305 million. Also as of January of this year, COPEL has been receiving in 30 monthly installments indemnification for transmission assets, which started operating after May of 2000. Indemnification amounts to R$ 894 million, restated by IPCA extended to consumer price index less 5.59% per annum. We will also receive an indemnification for assets, which started operating until May of 2000 amounted to 160 million. At the same token, we resolved to reject the government of agencies proposal to extend the concession of the power plants of Parigot de Souza, Chopim I, Mourao and Rio dos Patos, which together come from little less than 6% of our installed capacity.

The conditions for extension in this stage were clearly unfavorable to the company, which after a thorough analysis just to keep these assets only until the current contract expires.

The current energy position of SIN, Brazilian Interconnected System, have dropped and the SIN energy balance with resulting price increases in the short term, ended up proving that our decision was rightly made.

Actually, this prolonged drought and the pressure on the cash flows of our generation company and distribution company, basically explains our worked results on a year-on-year comparison. With this prolonged drought, we expect that the Araucaria TP [ph] to dispatch during the year of 2013, throughout the year.

In January, 8% of the energy was generated by them. This should positively reflecting the results after first half of 2013. So to readjust electricity prices, considering transport prices and generation from those assets, which accepted contract extensions and the reduction of sectoral charges, COPEL Distribuicao was subjected to an extraordinary tariff review, which should determine an average 19.3% tariff reduction coming to effect as of January 24, 2013.

This, however will not affect our distribution company's capacity to generate cash. We'd also like to remind you that our distribution company went through the same tariff review cycle in June of 2012 and therefore, we expect no more surprises beyond this line of business in the coming years.

And this recent move by the confession authority has made it even more urgent for us to focus on cost reduction. Immediately, COPEL management decided to conclude the permanent and voluntary resignation or redundancy program, PSDV, by the end of 2012 to encourage people to join and expedite the reduction in its payroll costs.

The result was that almost 1,200 employees joined, of which 790 in 2012. Although the program that will entail a reduction of at least to 10% in payroll costs to be seen already in 2014. It ended up putting pressure on our 2012 results, because perhaps the provision around R$ 170 million worth of labor indemnification and severance pay.

I would like to add that we have defined our cost optimization program and as soon as possible, we will disclose the agreed of horned value. And to our extension plans, we will actively participate in the extension cycle of the transmission system, which will include according to EBE, additional 10,500 kilometers of transmission lines in 21 substations. Other than that, we're working to deliver our new generation and transmission projects within our budget and time frame, and we'll continue to analyze other profitable operating assets.

We can never overemphasize our commitment to the principle of value creation and wealth generation to our shareholders in this extension move. In other words, any and all acquisitions to be made by COPEL shall be guided by the rationale to maximize cash flow and return to shareholders.

Finally, we propose the payout of R$ 269 million in dividends and interest on equity to our shareholders. A little over 38% of our reported net income of which R$ 138 million were paid in advance in January. The remaining portion of which approval by our General

Shareholders Meeting to be held on April 25th of 2013. I should also state that management of COPEL is aware of the demand by minority shareholders, who were asking for improvements in our dividend payout policy, and we intend to review it in due course.

I now turn the floor to Luiz Eduardo Sebastiani to present COPEL's 2012 economic and financial results.

Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

I thank our CEO, the CEO of Companhia de Energia, Parana, COPEL. Good afternoon, and I thank all of you who are participating in this conference call. To me, it is a great delight and honor to take over as Chief Financial Officer and Investor Relations Officer of COPEL, a company that I have always deeply admired. Given the lonely price in the economics history of the State of Parana, and being an important company for the development of our state and ultimately of Brazil.

I now introduce the results of 2012. The challenges are many. I was attracted to take over this job position because of these challenges.

I now take on the commitment to overcome these challenges, i.e., cost optimization, which is absolutely necessary for the company and for all companies in the industry. I have aligned strategies to cope with this need to reduce costs, absolutely a key to the company. So we will kick off a program that would guide very quickly and very consistently. Also, on our agenda is the challenge to review our dividend payout policy. So the dividend payout policy is always linked to the results of a company and should reflect a positive result.

Another challenge is to generate value for our shareholders, we're making prudent investments that will bring results to our shareholders. This is our focus. CRC negotiation with the State of Parana, to leverage funds for new investment and to get consistency to our dividend payout policy. So we have very substantial challenges ahead of us, but we have a very devoted team at COPEL. And then we'll be working, side-by-side with them to drive important results for our company. Thanks to the proficiency in the Brazilian electric sector.

I would like to move to slide four, where you can see our results. Here we can see the net operating revenue growing 10% year-on-year, reaching the mark of R$ 8.5 billion. This was driven by a number of factors, 12.6% increase in electricity sold to end customers. And 2.5% increased availabilities coming mainly from market expansion, the captive market grow 3.5% in 2012. And from the 2011 (inaudible) readjustment cycle, whose average increase was 3%, partially offset by 0.65% reduction related to the said tariff review cycle that COPEL went through in June of 2012.

On the next slide, we have some comments to make. Electricity sold to distributors was up 12.8%, primarily due to price increases and the power purchase agreement in the regulated market. This is a volume increase in bilateral contracts and particularly between higher revenue in CCEE submarket, pushed by an increase in spot market prices or PLD. Thus, revenue coming from electricity sales considering electricity sold to end customers, electricity sold to distributors in great availability grew 8.4% in the period.

Our operating revenues grew 93.3%, mainly caused by higher revenue from the lease at the Araucaria gas plant, as just mentioned, in fact, following contractual adjustments with Petrobras and its dispatch between March and December of 2012. It is important to highlight also the 7.2% increase in telecommunications revenue. Basically, to the new customers and the diversification in our product and solutions portfolio.

The customer base of COPEL Telecomunicacoes has increased to 3,141 customers, 117% up compared to 2011. In COPEL Telecommunications, operating all 399 municipalities of Parana State to become a 100% of the State of Parana, and another two municipalities in Santa Catarina state. Also, 18.6% revenue increase in distribution of pipe to gas, supplied by Compagas. It basically followed tariff adjustments, 8.5% as of August 2011, 4.5% as of March 2012 and 8% as of August 2012.

Now, we would like to talk about the operating cost and expense. In 2012, operating cost and expense has increased by 16.5% year-on-year, due to the following factors: Number one, a 13.4% increase in electricity purchased for resale. I'm going to give you more details on that later. The second point, a 22.1% upturn in charges for the use of the main transmission grid, which is the straight-up of new assets in the system and higher tranches. Reserved energy, EER, and systems services, ESS, partially offset by the fact that large free customers left the basic network. Thirdly, the 32.5% increase in natural gas and supply for the gas business following higher prices for the natural gas acquired by COPEL gas, mainly because of the depreciation of the Brazilian real and the price increase in the oil basket, which determines the gas acquisition price.

On the next slide, we talk specifically about the personnel account. Of the following situation, a 26.9% increase in personnel expenses -- the reason for leading into this personnel increase. This has been a high increase and needs to be explained. So, we give you a detailed information on that. There was a wage increase of 7.4% as of October of 2011 and 5.54% as of October 2012. Also, the indemnification in the succession and voluntary redundancy program amounting to 168.8 million. This was a prudent and necessary provisioning for the health of the company. And after this program is completed, there will be a reduction in the personnel account. I have already mentioned the wage increases. And, I stress 7.4% as of October of 2011 and again, 5.58% as of October of 2012.

Here, it is important to mention that we also reviewed the career and compensation structure in the company. We needed to align and the salaries that we pay with market salaries, so that we could reduce turnover. We're also -- we run the risk of losing our executives to the market. So, we needed to review the career and compensation structure that led to another personnel cost increase. But again, I wanted to mentioned the PSDV, the succession and voluntary redundancy program. It means, the cost now, but later on it will show a release in our personnel account and our payroll costs. When all of these employees are terminated, there will be a payroll cost reduction of around 10% to be felt in 2014.

On slide seven, we break down the energy purchase for resale and we compare with a 2011 budget. To be highlighted, here is the higher cost related to the energy purchases at auctions in the regulated market, the so-called CCEAR. Excesses to purchase energy from CCEE and Itaipu. The purchase of energy in the regulated market grew for a couple of reasons; One, market growth, I would like to remind you that the captive market grew 3.5% in 2012. Secondly, monetary restatement of contract, IPCA was 5.84% in 2012. And certainly, higher costs with CGP contracts given the increase of their relative share in the purchase of energy and acceleration of the stock market price within the first quarter caused that CGP is to dispatch energy.

The expense increase in CCEE stems from the significant spot market price increase throughout the year. With the average price in the range of R$ 30 per megawatts in 2011, increasing to R$ 160 per megawatt hour in 2012. And also central electricity generation below the physical guarantee observed in the fourth quarter of 2012, which costs 63 million through COPEL Geracao and Transmissao. Finally, the expense increased related to a tax boost driven mainly by the real depreciation vis-a-vis a dollar of around 20%, when we compare the average exchange rate of 2012 for that of 2011.

On Slide eight, we give you the consolidated EBITDA for 2012, which shrunk 18.9% compared to 2011, totaling R$ 1,500,000,000 and an 18% margin of the operating revenue, as you can see on slide eight. COPEL, Geracao e Transmissa accounted for 73% of the cash generated, while COPEL Distribuicao contributed with 8%.

On the next slide, slide nine, we give you COPEL's net income, which was R$ 726.5 million in 2012, 38% down compared to 2011. In addition to those effects, they put pressure on our operating cash revenue. Adjustments made in the asset base of our distribution company, that contributed to a net income reduction. These adjustments are related to the third tariff reading cycle that we had in 2012. Many companies are going through this process with monthly financial situation of companies.

And secondly, the extension of the life cycle of assets, as of January of 2012, as determined by ANEEL. Together, these effects led to an additional financial expense of R$ 401 million in 2012 related to the reevaluation of the front value of our distribution asset. The highest impact has been absorbed in 2012, and that is important looking forward. Thus, the consolidated profit margin was 8.5% in 2012 with our generation company hitting the mark of 31%, while our distribution company proceeding a negative 0.7% net profit, due to the factors mentioned previously.

On slide 10, we have the EBITDA and consolidated net income of the company for 2012, net of extraordinary effects and in comparison with 2011. So, if we were to disregard that the negative CVA movement of 125 million. The energy purchase in the stub market to cover the physical guarantee of our generation company amounting to 63 million and the PSDV indemnification amounting to 170 million EBITDA or would have been 1.909 billion in 2012.

And if we were to eliminate the previously-mentioned factors that impacted EBITDA, R$ 401 million related to the reevaluation of the fair value of our distribution assets. It was mentioned before, it's a new estimate of the life cycle of these assets. Depreciation rates into the non-recognition of a part of our asset base, we would have reached the net income of 1.185 billion in 2012 compared to 1.155 billion [ph] in 2011.

So net of these event, we would see a certain stability, which does not eliminate our challenge and our focus to reduce costs. We have to pursue the orientation of our CEO, of having the company altogether move towards cost reduction. In a nutshell, these were the highlights of COPEL's results. It is clear that 2012 was a year of adjustments and we are working to deliver much better results in 2013.

I have observed that COPEL's shares are traded at much lower multiples than the multiples of our peer company.

Now, I want to tell you that my actions will be geared primarily to align our multiples and recover the value of our shares. This is our motto, the determination of our company, of our CEO and that we will follow, to deliver good results, because we have a very high-level technical team in the electric business. We have all the right conditions to raise the bar for COPEL. Thank you very much for your attention.

Questions And Answers

Operator

Ladies and gentlemen, we now will begin the question-and-answer session. (Operator Instructions) Our first question comes from Ms. Lilyanna Yang from UBS. Ms. Yang, please go ahead.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thank you for the opportunity. I would like you to comment on your strategy to commercialize energy of COPEL Geracao. I've been hearing the allocations were made in January, but for 2014 and '15, I would like to know what is the level of contracting and how do you believe is the best way to commercialize this electricity?

The second question. I would like you to explain the dividend payout policy. Do you understand that the company should be more leveraged than it is now or perhaps, get down to two times of net debt over EBITDA ratio?

A - Lindolfo Zimmer {BIO 2132989 <GO>}

To answer the first question, regarding the commercialization of electricity. In the future, I'll consider them. For 2013, we are fully contracted. The surplus that we had, 8% which was in reserve, was sold very early at a very attractive price. And now, given yesterday, recognized to our new management. That's a launch of real [ph] the seasonality of energy, we'll have to be subjected. But the situation is quite good for 2014, '15, in terms of shortage of electricity and energy.

I believe that the conditions will also be favorable. Perhaps, not the same as 2013, but, we know that the system has just enough to meet the demand and even considering the EBITDA growth, we know that all CPDs will be dispatched during 2013. About 15,000 megawatts being dispatched by thermal power plants, including all of them, so, that the costs are significant. That will make our energy. Wind power, which is cheap, will be an excellent opportunity to help in this commercialization. We have not defined it as yet, what would be the right strategic mix. We have to know how the industry will behave. We have to know how the economy of the country will behave and the demand and that will define the cost for contracted energy and for our own generated energy.

A - Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

This is Sebastiani, I will try to answer your question about dividend, the dividend policy. This is indeed a challenge for the company. The main challenge is to address the dividend payout policy. We aware that it is necessary to align it with the average of the electric industry. The challenge is to link the financial capacity to generate profits, to leverage new investments. So, that we can have a higher dividend payout. This is an interesting and complex challenge, but for the manually, with a change in the company's agenda.

As I mentioned during the presentation, we should have a more, let's say, firm policy for dividend payout. This is understood by our financial department. Our CEO shares the same understanding. But, the dividend payout policy needs to be firmer. So, the message to our shareholders is that this is going to be tackled. This will be important for the growth of the company. It is one of the challenges.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Well, thank you. If I try to understand your leverage, your debt is too low. For example, your net debt over EBITDA ratio, it's around two times, right? Do you think you need a more aggressive investment policy, more aggressive than what we've seen in the last two years?

A - Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

Well actually, we see and others that we hope follow the company will definitely see that the company has an important debt level. The same kind of alignment that we have to have in terms of dividend payout policy, we have to have in terms of the investments to be made by the company in the electric sector. We have to analyze the company's condition to get more debt, but you'll see, Ms. Yang, we're following our guidelines and we have to work together with the engineering department of the company. If they're identifying the opportunities for investments in the market, well, that kind of demand has to come from the engineering group. We will thoroughly consider these investments. This isn't important for the company, for the pioneers of the company. Anyone finds out the dividend payout policy. So again, new investment. Have to get our full and total attention. We just have to look for new sources of revenues. This is absolutely key to contain expenses. So, this is something that is also part of our work agenda. Thank you very much.

Operator

(Operator Instructions) Our next question comes from Mr. Oswaldo Telles from Best Securities Company. Mr. Telles, you may go ahead.

Q - Oswaldo Telles {BIO 2484407 <GO>}

Goof afternoon to all. Regarding two topics that you've mentioned. One is about the CRC negotiation. I would like you to elaborate a little bit more. I would like to understand where the negotiation stands.

And my second question has to do with the personnel reduction, headcount reduction. This 10% reduction in payroll costs. Can we expect that effect to be seen in 2013? And the cost, would the cost reduction be directly related to the amount of indemnifications paid or do all the indemnifications account for more than 10%?

A - Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

Hello, Mr. Telles, Good afternoon. What's your first question about CRC. You all know, the association between our company and the governments of the state. The state has a debt to COPEL was R$ 1,340,000,000, that is the amount of the debt initially. The interest rates are (inaudible) it would be GPM, GPM actually, high GPM for the certain percentage. And the profile of the debt is such that the State of Parana or the entire proved to pay revision of the payment of the debt, not with regards to COPEL.

They are renegotiating other debts as well. And the debt that they have with us is a good debt, and once again these financial resources have lower interest rates. Not based and not back to high GPM, but perhaps in dollars, if I'm not mistaken. This is an operation that is ongoing, or it is up to us to analyze this proposition, because we could have the funds anticipated to us.

If the CRC negotiation comes about in a very transparent way and it couldn't be any different than that, the funds would be linked to an important investment to the company, and are leveraging new sources of revenue for the company. It would be a guarantee that COPEL would not face a default. That's actually happened in the case of (inaudible) State, where over the history, there was an accumulation of defaulted payments. And that led to a compulsory contract review and it was very complicated and unstable situation.

So, we are looking into this year, to negotiation very carefully from the standpoint of the company. It could be, it is an adequate work, but we have to take into account the interest of COPEL. Is it worth having this anticipation? This payment brought forward? Linked to its strong program of business for the company in an investment for the company? That debt would be an important deliverable, if the negotiation comes about. But, we're still halfway in the process. We'll still have some details to define, but fundamentally, COPEL has to conduct a study that would give us a subsidies to go on with this negotiation that we're bringing forward to the CRC payment.

And as of the second question, if the 10% will be focused in 2013 and the answer is, no. We said in the presentation and we work from here, that this benefit, a 10% reduction in payroll cost will be felt in 2014. In 2013, the effect will be, on average, 3% only. It is still an interesting result. We are preparing the headcount of the company and these people, who are resigning from the company are very experienced people, and we are working to have them find another position elsewhere.

Q - Oswaldo Telles {BIO 2484407 <GO>}

Thank you very much.

Operator

(Operator Instructions) Our next question comes from (inaudible).

Q - Unidentified Participant

Good afternoon. Thank you for allowing me into another question. When the new Governor took over in Parana, a few years ago, the hope was that the utility environment in your state would be very conducive to investing. And yet, the stock has -- COPEL stock has been quite core relative, down almost 30%, just even over the past year. Investors should have absolutely no confidence with the capital allocation strategy of your former management team and that's why I'm assuming I'm talking to a new management team. The stock trades at 60% of book value, 6 times consensus, 14 estimates, which tells you that investors have absolutely no faith in the outlook for this company.

And so as you think about formulating this strategy, specifically on a capital allocation strategy, I just wanted to ask a couple of specific questions for those of us who actually are investors in your company and frankly, a large investors in your company.

The dividend payout policy has been pathetic, beyond pathetic and frankly, if you just raised your payout ratio from 38% to 50%, and cost of incremental 100 -- around approximately R$ 150 million [ph], shareholders would kiss the ground that the company actually responded to shareholders. You have many extraneous assets, like your Telecom assets that could have been sold at a very high price. If I wanted to go invest in a telecom company, there are many very good companies in Brazil, no one buys COPEL stocks for its telecom assets.

And so, could you actually help me understand what sort of investment criteria will be used in terms of your expected returns about the company's cost a capital going forward? And that this capital allocation strategy can be put in place, so that some value can be finally realized in COPEL stocks. Thank you.

A - Lindolfo Zimmer {BIO 2132989 <GO>}

Good afternoon. I would like to thank you for your question. Unfortunately, you were cutting off, and we'd like to apologize, if you don't answer your question in full. But, I believe you asked about the dividend payout policy of the company. If we were continue to grow -- there was a slight growth this year, especially compared to 2011, it was 38% of our reported net income, in 2011, around 35%. And that same issue related to the investment policy of the company. And that's where the secret lies I guess, the main issue. These things are not disconnected to us.

On the contrary, we want to have these two policies linked, a more important dividend payout policy, will be able to give the company new investments, sums for new investments. And new investments that will give us a profit or return above the cost of capital. We are being very diligent in pursuing this. The electric sector is growing. We're identifying new energy sources, new frontiers, new geographic frontiers in our country. We are no longer limited to Parana for quite a while. Now, we are diversifying now. Diversifying projects, projects that are operational, that have insured revenue or assured revenue, and we have to identify opportunities to have the return on capital.

Given the efficiency of the company, the current efficiency of the company, and we intend to increase our efficiency, given our engineering team. We intend to have the return or profit cost of capital. And if you could see here, where I would like to add, since the beginning of our management two years ago, we committed that our investments will be healthy and solid. Since to add value to the company. To generate, to create the value and this is how we have been operating.

And so the investments we've made, all of them have a better return than other investments made in the past. And we want to maintain this policy. It could not be different. We were not be in a position to make investments that would not bring the result to shareholders. This is the reason of our existence. It doesn't make any sense to change that. The controlling shareholder, the State of Parana, wishes to have that relentlessly. The government of Parana also needs the resources to invest in the social program and to supply the needs of the State of Parana. And all of the other shareholders, they also want to have their investments growing healthily. So, this policy will be definitely maintained and incremented, if possible.

Obviously, it depends a little bit on the speed of the growth in the electric sector. Sometimes, they move the economy and that the growth of the sectors doesn't happen as fast as we would like. But we want to have investments, always, that will bring us healthy results.

Operator

(Operator Instructions) Well, there are no more questions and we would like to give the floor to Mr. Lindolfo Zimmer, the CEO for his final remarks.

A - Lindolfo Zimmer {BIO 2132989 <GO>}

Before ending, I would like to emphasize what was said by our CFO, Sebastiani. 2012 is a year of adjustments, and I am sure that 2013 will be a year, when we will turn the page. We will have a totally different year, a better year, in all of our lines of business. And once again, I would like to thank you for joining us, for participating. We remain available, our Investor Relations department remains available, if you need any further clarifications. Thank you very much.

Operator

Ladies and gentlemen, COPEL's 2012 results conference call is now finished. We thank you for participating and wish you a good afternoon.