

Q2 2016 Earnings Call

Company Participants

- Luiz Eduardo da Veiga Sebastiani, Chief Financial Officer & Investor Relations Officer
- Luiz Fernando Leone Vianna, Chief Executive Officer, Secretary & Member of the Executive Board
- Sergio Luiz Lamy, Chief Executive Officer of Copel Geração e Transmissão SA
- Unverified Participant

Other Participants

- Maria Carolina Carneiro, Analyst
- Vinicius Canheu, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, and thank you for waiting. Welcome to Companhia Paranaense de Energia - Copel's Conference Call to present the Second Quarter of 2016 Results. We would like to inform you that all participants will be in listen-only mode during the company's presentation. Afterwards, we will have a question-and-answer session when further instructions will be given.

Before proceeding, we would like to clarify that forward-looking statement that might be made during this call related to Copel's business perspective, operating and financial projections and targets are beliefs and assumptions of the company's management, as well as information currently available.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions as they refer to future events, and therefore, they depend on circumstances that may or may not occur. General economic conditions, industry conditions and other operating factors may offset the future performance of COPEL and may lead to results that differ materially from those expressed in such forward-looking statements.

Today with us, we have Mr. Luiz Fernando Leone Vianna, CEO of the company; Mr. Luiz Eduardo da Veiga Sebastiani, CFO and Investor Relations Officer; Mr. Jonel Nazareno Iurk, Business Development Officer; Mr. Sergio Luiz Lamy, President of Copel GeT; Mr. Ricardo Goldani Dosso, President of Copel Renováveis; and Mr. Francisco Cesar Farah, CFO of Copel Telecom.

The presentation that will be made by Copel's management may be accompanied at the company's website, www.copel.com/investorrelations (sic) [www.copel.com/ir] (02:27).

Now, we would like to give the floor to Mr. Luiz Fernando Vianna, CEO of the company.

Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

Good afternoon, and welcome to our conference call about the results of the second quarter of 2016. 2016 has been a very intense year so far we are crossing (02:53) we are having political, economic, social and even sports events, which give us the sensation that a lot is changing. As far as Copel is concerned, 2016 is off to a very intense year. Challenges are overcome every day and put a lot of work and results, we have been achieving our objectives and improving our company. One of the objectives was reached at the beginning of the fourth tariff review cycle of Copel Distribuição. We worked with much dedication in the last few years to improve the quality of the services delivered, and we carried out a robust investment program in the last four years and practically doubled the size of our distribution company, which now has an asset base of BRL 4.9 billion.

All these investments besides giving us have a higher return to our shareholders, it's perceived by our customers through the recognition of Copel service quality. In 2016, Copel Distribuição was voted for the third consecutive year as the best energy distribution company in Brazil in the opinion of customers. This was the fifth time in the last six years that we won this award, and this makes us very proud because it concerns the quality of our service, which is delivered to a customer that is very demanding.

At the beginning of the fourth cycle - the beginning of the fourth cycle also brought up other very interesting aspect to our customers. Tariffs charge by Copel Distribuição dropped on average, 13% being the residential class, which represents the most in the captive market, had a deduction of 14.3%. This reduction, besides representing savings for our customers, is positive also for Copel because it should encourage a rebound in consumption and reduce delinquency factors that have been affecting the distribution company results in the last few quarters.

In the segment of transmission, the Ministry of Mines and Energy brought news about the RBSE indemnification, which are the transmission assets existing in May 2000, by means of Ordinance 120 of this year, the Ministry established the inclusion of the RBSE in the regulatory asset base. A restatement of the value of assets since 2012 and payment of indemnity by means of the RAC (05:53) as of 2007 tariff process. With that, the company based on the ANEEL tariff regulation procedures, we calculated the cash flow estimate for these assets, and this had a positive effect of BRL 978 million in the operating revenue of the second quarter. And it is important to stress that this calculation was made based on the best estimates of our management funds. ANEEL has not yet ratified the final result of the evaluation report of Copel's assets.

The fourth slide shows that 2016 has been very intense in the evolution of many projects that we are either building directly or by means of participation. As you can see on slide number 4, we started operation of the Bateias - Curitiba Norte transmission line and the

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Curitiba Norte substation. This project that operate at 230 kV required BRL 69 million in investments and adds about BRL 8 million to the Copel GeT work (07:16). Still in Copel GeT, we received the environmental license for the beginning of the construction of the fourth and last stretch of the (07:27). And we expect these lines to start up in April 2017 when it will be adding BRL 27 million to the Copel GeT work (07:42).

With relation to the transmission SPEs (07:46) on July 29 (07:48) obtained upgrading license, operational license, which allows the commercial operation of the project made up of over 1,000 kilometers of transmission lines in two substations, adding a wrap (08:03) of BRL 61 million to Copel. And it's important to see that in the lines, we will have 100% of the energy of the (08:18) plant. They distributed SPE (sic) [SPC] (08:23) Guaraciaba, which will also distribute energy from the [indiscernible] (08:27) has already been tested. And now, only the license for operation is still waiting to start commercial operations. And lastly, the Paranaíba SPC (sic) [Paranaíba SPC] (08:40) is concluding the construction of 967 kilometers of transmission line, which will help in the interconnection of the Northeast region with the Southeast and should start commercial operation the next few weeks.

Jointly, these three projects, Matrinchã, Guaraciaba and Paranaíba, represents an additional BRL 132 million to Copel's wrap (09:09). Now it's a great honor for me to give the floor to Sebastiani, our CFO, and he will be talking about the results of the period.

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

Thank you very much, Mr. Vianna, our CEO, and other officers of the company who are present here in this room, and thank you very much for your interest. Good afternoon to our investors and analysts, and once again I thank you for participating in our call.

Before talking about the results, I would like to say that we concluded successfully the long-term financing for the Brisa Potiguar wind farm, which is in operation and we are going to (09:52) by means of an important partnership with the BNDES we finished a BRL 300 million debentures private issue, which was totally subscribed by the development bank across that that (10:04) involves many challenges and was pioneer in the Brazilian electric sector.

The conclusion of this operation opened the platform (10:13) that we may obtain with the BNDES long-term financing for other projects that we are building such as the (10:21) transmission lines and the wind farm (10:26) and about the results as you can see on slide number 5, we had important event that were recorded in the second quarter of 2016, starting with the RBSE. As already mentioned by our CEO, we recorded extraordinary revenues of BRL 978 million in the this line of availability referring to the remeasurements for fair value of the transmission assets according to the Ministry of Mines and Energy.

On the positive side, we had BRL 211 million in provisions for litigation and the main one is BRL 193 million from a victory that we have gained in a claim that demanded a payment of (11:12) and the respectable interest and fines related to August 1995 to December 1996. On the other hand, we recorded BRL 147 million in provisions made up mainly by BRL 80

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million referring to administrative and labor litigation, and BRL 61 million related to allowance for Delta (11:33) accounts especially in the distribution company.

Going to slide 6, we present the details of our operating revenue that had a reduction of 6% in the second quarter of 2016, being close to BRL 3.7 billion. And the main reason for this drop was the 40% reduction in revenue from sale to other utilities due to the non-operation of our Araraquara thermal power plant in the quarter. The variation that we see in revenues was impacted by the lower results from sectorial (12:14) financial assets, and liability is negative at BRL 727 million due to the amortization of BRL 398 million due to the recovery via tariff of the deferrals realized in 2013 and 2014, and also the lower cost with the purchase of energy vis-à-vis the tariff coverage, on the other hand, revenue from the use of the power grid grew by 273%, which can be explained by the remeasurements of the transmission assets referring to the RBSE as I mentioned before.

Revenue from sale to end customers increased by 4% due to the adjustments applied to the tariffs of Copel Distribuição over last year. Nevertheless, these adjustments were negatively affected by charges and the drop in the captive market of Copel Distribuição in the three markets of COPEL GeT. The other operating items composed by telecom revenue, gas (13:18) distribution and others grew by 7% showing mainly the 20% increase in the telecom revenue, which comes from the increase in our client base.

On the next slide, we give you details of the operating cost and expenses lower than BRL 2.4 billion in the second quarter of 2016, 34% lower on a year-on-year basis. And this is driven majorly by a 41% slump in the process of purchase of energy (13:51) driven by the end of existing energy contract that we replaced by energy contracts coming from the Quanta System, clearly cheaper, and the reduction in the (14:04) tariff as well.

On the other hand, we see that we had a 9% growth in the charges for the use of the grid coming from the higher expenditures with Reserve Energy. Managing those (14:18) costs went up 13% in the second quarter of this year driven by higher expenditures with payroll and third-party services due to inflation that reached about 10% in the period, beside the increase in other costs such as leases and rents and the discontinuation and sale of assets.

The provisions and reverse supplying was positive by BRL 64 million, the behavior in which can be explained by the recording of the reversible BRL 193 million in provisions for fiscal litigations related to COFINS as we have already mentioned, and this was offset by the recording of provisions for administrative and labor litigation and credit for doubtful accounts mainly in the distribution company.

This slide - slide number 8 shows that EBITDA was 212% higher to the one posted in the same period last year, amounted to BRL 1.5 billion with a margin of 41% over the operating revenue. Growth can be explained by the remeasurement of assets related to the RBSE, which allowed for an increase of BRL 978 million in the period.

Cash generation of Copel GeT accounted for 91% of the consolidated EBITDA. Copel Telecom, 2%, and the other companies of the Group accounted for 7%, and the main

contribution came from (15:52). Copel Distribuição closed the second quarter of 2016 with a negative EBITDA of BRL 169 million vis-à-vis a positive result of BRL 196 million in the same period in 2015. The result was once again impacted by the drop in the market and by the recording of provisions especially for doubtful account that were BRL 43 million higher than the tariff coverage in the period.

On slide 9, we present the consolidated net income of Copel, BRL 997 million in the second quarter of 2016, 230% higher on a year-on-year basis. Analyzing the results of subsidiaries, we can see that Copel GeT closed the period with a net income of BRL 839 million, Copel Distribuição loss of BRL 64 million, and Copel Telecom, positive BRL 15 million. These were our highlights, and now we would like to open for questions from you. Thank you.

Q&A

Operator

Now, we will start the Q&A session. Our first question comes from Mrs. Carolina Carneiro from Santander. You may proceed.

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

Good afternoon, everyone. I have two questions. The first one has to do with the posting of the RBSE, recording of the RBSE that you had in the second quarter. I would like to know if you can give us more details about that, which will be hypothesis that you had to reach this amount that you mentioned in revenue in order to post this amount, and do you have any expectations regarding when Aneel (18:05) will manifest itself about this register and open a public hearing maybe about the same? And the second question has to do with energy from generations. In your Genco, do you have energy available and anything new about the negotiation of new contacts for the synergy?

A - Operator

I would like to ask Adriano (18:38) to answer your first question, because he's in charge of our accounting.

Carolina and everybody, good afternoon. Regarding the accounting for the RBSE, it was the most relevant event in our quarter, and I can say in a few words, after we have all demands, BRL 120 million in April 2016, we have debated this very extensively with agents of the sector and with our auditors and the technical people in Copel does not have the totally ratified by now yet.

So we took all the assets that were in operation in May 2000 and the same list of asset that we sent to at Aneel (19:24) when we submitted this, and we estimated the new replacement value for these assets so we took the methodology of Aneel (19:33) and we estimated what would be the new replacement value. According to this methodology, we reached almost BRL 1 billion that we recognized in our revenue. Together with that, we had the agreements, they are supplying the methodology of Ordinance 120 million with

the regulatory SEC, the (19:56) itself. So applying both methodologies, our value was very much compliant with this amount.

So what we are expecting is a manifestation of the part of Aneel (20:13) and we were there quite a few times at Aneel (20:17). In order to mitigate the interest that we still had and our expectation is that in the second - the next quarter, we will have this issue solved, and we expect these amounts to be confirmed regarding this indemnification. Thank you very much. I would like to ask Sergio Lamy, who's the President of our Genco Company, to answer.

A - Sergio Luiz Lamy

Carolina, good afternoon. With relation to the negotiation of new contract, we - at the end of last year and beginning of this year, we monitored the behavior of the price curve, and as we saw some sign that the price of energy was going up, then we started with the new commercialization strategy already in the first quarter of this year. We started to sell energy in many different auctions in limited value, the limited amount, because with this perspective that is what is really going on. We wanted to optimize our average price.

I do not have the amount showed here, but it was a significant amount. So since the beginning of this year until the last auction that was held in August, but what I can tell you is that we have already about 75%, 80% contract for the energy that we produce, and for 2018 (22:25), already 60%, around 60%. So, this commercial strategy will continue. We are having auctions in a limited quantity and did many auctions. We continue with the same strategy for the second half of 2016.

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

What about price or price range for these contracts?

A - Operator

The most recent contract for conversion of energy for 2017 are around BRL 160 per megawatt hour, for 2018 (23:07), BRL 150, BRL 185 for 2016, and over BRL 200 per megawatt hour for 2017 on.

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

Thank you.

Operator

Mr. Vinicius Canheu from Credit Suisse.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Good afternoon. I have a question about distribution. For several quarters, we see very high provisions in distribution. I remember I heard about this in other conference calls, and you said that you still have had many workers that were participating in the redundancy program, the labor redundancy program, and now we see the level of provisioning in

distribution that continues to be very high, but mainly because of doubtful accounts. So, could you give more details why do you still have such a high level of provisions and when you expect this level to go down?

A - Operator

Adriano (24:40) will be answering your questions.

Good afternoon, Vinicius. Regarding your question, this is one of the issues in our control cockpit, because this is of concern to us, and with the support of our executive committee, we hired a company from outside to review all the processes. All the issues, all these claims, and so if we add up all these contingencies, the amount is quite expressive. So, we are starting this in the third quarter, and we expect to be able to have a very positive result from this endeavor. I would say that for the second half of the year, we really expect to give you some good news in this regard.

Q - Vinicius Canheu {BIO 6300903 <GO>}

So the monetary restatement value is mostly concentrated in this figure that we see in your operating result and not in the financial result, is it what you mean?

A - Operator

Yes, that is correct. Copel historically has always restated contingencies in the operating results, so you are right in your statement.

(26:19).

Good afternoon. I would like to know about your reversal of the positions for litigation regarding the COFINS stocks (26:33). I think I read something saying that this discussion was in the hands of (26:42) and that you expect more discussions about that regarding interest adjustments.

Good afternoon, (26:50). With relation to the COFINS position, today there was an article published because we have two large suits in the administrative instance of IRS. One has to do with 1996, 1997, 1995 and 1996, which is being evaluated by COFINS. But the second one that we had was referring to 1998 to 2001. Essentially, it has to do with the collection (27:22) of COFINS on electricity charges. So, we have already been successful in the second case, and there is no appeal possible in the part of the IRS. So we were able to totally reverse these BRL 190 something million and also remove this possibility. So from 1998 to 2001, the issue is closed. So this is the reversal that we put in our balance sheet, and because it's evaluating the other period, and the essence of it is the same, and we expect to have good news to inform to you.

What will be the amount of this other period, which is already provisioned?

1995 and 1996 provision of BRL 45 million for this specific claim.

Thank you.

As there are no more questions, we would like to turn the floor back to the company for the closing remarks.

A - Unverified Participant

We would like to reiterate the fact that this is an unprecedented year in all aspects. We understand that as of the third quarter, we will be seeing a higher degree of stability, some new definitions, and we are facing a bet (30:19) on the new management of the Ministry of Mines and Energy, already giving a very good contribution to the country and to the power sector of Brazil. And with better communication between the agents and the Ministry and we already see this coming back.

And of course, if you wish to ask other questions or if you have any doubts after we close this call, we remain at your disposal, and of course we expect to see you all in our next conference call, and we expect to have good news to convey to you. Once again, thank you very much for your presence, and I wish you all a very good weekend.

Operator

Copel's conference call is closed. We thank you for participating, and wish you all a very good afternoon.

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