

Q1 2016 Earnings Call

Company Participants

- Luiz Eduardo da Veiga Sebastiani, Chief Financial Officer & Investor Relations Officer
- Luiz Fernando Leone Vianna, Chief Executive Officer & Director

Other Participants

- Marcelo Sá
- Miguel Rodrigues

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon and thank you for waiting. Welcome to Companhia Paranaense de Energia Elétrica Copel Conference Call to discuss the first quarter of 2016 results. We would like to inform you that all participants would be in listen-only mode during the company's presentation. Afterwards, we will have the session for questions-and-answers when further instructions will be given.

Before proceeding, we wish to clarify that forward-looking statements that might be made during the call related to Copel's business perspectives, operating and financial targets and projections 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 will depend on circumstances that may or may not occur. General economic conditions, industry conditions and other operating factors may affect the future performance of Copel, leading to results to differ materially from those expressed in such forward-looking statements.

Participating in this call, we have Mr. Luiz Fernando Leone Vianna, CEO of the company; Mr. Luiz Eduardo da Veiga Sebastiani, CFO and Investor Relations Officer; Mr. Gilberto Mendes Fernandes; Business Management Officer; Mr. Jonel Nazareno Lurk, Business Development Officer; Mr. Antonio Sergio de Souza Guetter, President of Copel Distribuição; Mr. Sergio Luiz Lamy, President of Copel GeT; Mr. Ricardo Goldani Dosso, President of Copel Renováveis; Mr. Franklin Kelly Miguel, President of Copel Comercialização; and Mr. Francisco Cesar Farah, CFO of Copel Telecom.

So this presentation will be made by Copel's management and it can be followed at the company's website, www.copel.com/investorrelations.

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

Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

Good afternoon, everyone, my colleagues in the executive committee, all participants. Welcome to our call to talk about the results of the first quarter of 2016. I would like to start by talking about important regulatory issues that will or could be relevant impact on Copel.

The first point and it couldn't be different is the 4th Tariff Revision Cycle of Copel Distribuição. We certainly are a company to develop such a process. As you already had access to the documents available at the ANEEL website in the Number 20 Public Hearing that shows a net remuneration base of BRL 4.8 billion for the new cycle. This increase means that our distribution companies doubled in size in the last four years.

However, it is important to highlight the investment was not made only in good extension. We also invested quite a lot in the improvement in the quality of service that we deliver, and this led us to be recognized as one of the best dis cos (04:06) in the country.

Now, with the beginning of the fourth cycle, all these investments will be remunerated. And for this reason, we are certain that we have adopted the adequate strategy for the business. The fourth cycle still brings about other important points, such as the remuneration of special obligations and the trajectory of costs that will allow us to have a more adequate coverage for the PMSO expenditure within the cycle that start in 2016.

Nevertheless, the most interesting point is that the practices - the clever strategy by Copel Distribuição should suffer a reduction of approximately 10% with the beginning of the new cycle, which is positive for consumers because they will be spending less with energy and for the company as well because it brings a substantial delinquency reduction and growth in consumption, factors that have been impacting our results in the last few quarters.

However, it's important to stress that the process hasn't been concluded yet. The hearing is still open until May 19. And after this stage, the process would be validated and ratified by the ANEEL administration and conclusion is estimated for the end of June.

Continuing with the regulatory theme, as Resolution 706, coming from Public Hearing 04, talks about an important advance into the issue of involuntary over-contracting of business. The new rule allowed us to consider part of the energy that we receive through the quota system as involuntary over-contracting, which was enough to mitigate Copel's distribution risk negative as seen.

In transmission, the Ministry of Mines and Energy got the news about the RBSE implementing, which are the transmission assets already existing in May 2000. By means of Ordinance 120 of 2016 and ANEEL established the integration of RBSE to the regulatory

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asset base, the restatement of the value of the assets since 2012 and payments of indemnity by means of RAP since the tariff process of 2017.

This is interesting to say that the cost of own capital to be considered in the restatement of the asset value is 10.4% in real terms, which allows us to have this adequate restatement of the amount to be indemnified. In the case of Copel, this amount has not been ratified by ANEEL yet. And I would like to mention that any effect on our results or conditions to the ratification of the final result of the evaluation report by the regulators, ANEEL. Just to remind you, in March 2015, we submitted to ANEEL the evaluation report to the amount of BRL 882 million referring to RBSE and the date of it was December 31, 2012.

On slide number 4, I would like to highlight that we have important achievements related to the projects that we are building. Starting with Colíder, the Supreme Court of Justice, in a decision supported by technical studies, canceled the injunction that mandated Copel GeT to suppress 100% of the vegetation of the area to be flooded by the reservoir, and confirmed that the suppression of 70% of the area was environmentally adequate. With that, the work is then concentrated in the construction of the transmission line that will be linking the Colíder plants to the interconnected systems and the electromechanic assembly of the equipment. Commercial operations should start in the first half of 2017.

We also had an important achievement related to the Baixo Iguaçu project in which we hold a 30% stake and we are building in partnership with Araucária in a recent decision. And they approved an additional 130 days for waiver of responsibility for the plant and the total number of days now is 756, which means at the beginning of the sale to other utilities was postponed to the end of 2018. And this is enough time for us to build the plant and start commercial operations.

In the transmission segment, SPC Matrinchã concluded its construction work and over 1,000 kilometers of lines have already been planted and commissioned successfully. And now we need a confirmation by the regulators in order to officially start operation of these projects. Besides Matrinchã, other transmission projects are about to be concluded and start commercial operation.

SPC Guaraciaba should start up by the end of June, whereas SPC Paranaíba has already concluded construction of 346 kilometers of lines and should come on-stream by the end of next month. Jointly, these three projects will bring about to Copel around BRL 158 million.

Lastly, I would like to highlight that we have recently held two auctions for the sale of energy in the free market in which we have sold over 6 million megawatt hours in products, where delivery in two to five years and starting delivery as of June 1, 2016, then January 1, 2017, and then January 1, 2018.

Our strategy is to hold additional auctions in order to reduce the amount of energy, whose contracts have been terminated and allows a better predictability for the

generation business. It's important to highlight that the results already obtained allows us to make or give a significant step in order to reach this objective.

Now I give the floor to my colleague, Sebastiani, our CFO, who will talk in detail about the results for the period. Thank you.

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

Thank you, Mr. Luiz Leone Vianna, our CEO. As he said, we have a participation of all these executives due to this important moment for the company and thank you very much for participating in this call.

As you will see on slide number 5, some events again impacted our results in the first quarter of 2016. We posted over BRL 120 million in provisions, of which BRL 84 million are related to labor litigation and BRL 32 million to civil losses. We posted BRL 38 million in allowance for doubtful accounts because of the economic crisis that we are going through in Brazil and that has a direct impact on Copel Distribuição results. Economic crisis has been impacting energy consumption leading to a drop of 4.3% in the capital market of Copel Distribuição, in line with the drop in consumption that we see in the country.

The decrease in Copel's results is also explained by the lower results of Araucária TPP, which represented only (12:42) the first quarter of 2016, accruing BRL 14 million loss in the period vis-à-vis earnings of over BRL 150 million in the first quarter of 2015, besides the drop in results which also impacted by the lower allocation of energy at Copel GeT to the short-term market aligned to the lower value of the spot price in the period.

Slide number 6 now, details of our operating revenue, with the reduction of 27% in the first quarter of 2016, being close to BRL 3 billion. The main reason for this decrease is the recognition of the result of sectorial assets and liabilities that was negative by BRL 527 million in the first quarter of 2016, when there was a positive result of BRL 561 million in the first quarter of 2015 due to the amortization of BRL 402 million in the period coming mainly from the recovery via tariff of the deferrals realized in 2013 and 2014, and the negative constitution of BRL 144 million coming from the reduction in the value of the CDE, the economic development account, and the lower cost with the purchase of energy vis-à-vis the current coverage.

Revenue from delivery to end customers grew by 19% due to the adjustments of the tariffs to the Copel Distribuição tariff over last year. Nevertheless, these adjustments were affected negatively by the charges and by the slowdown in the captive markets of Copel Distribuição and the free markets of Copel GeT.

Revenue from sales to other utility, that means the many of the sales of Copel GeT and all the sales of Araucária TPP had a 47% reduction in the first quarter of 2016, resulting in the lower dispatch of TPP, the lower volume of energy allocated by Copel GeT, and lower spot price as we mentioned.

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Revenue from the use of the power grid grew by 44% due to the tariff adjustment applied by Copel Distribuição in June 2015 and also the increase of revenue of the transmission segment coming from the RAP adjustments and the startup of new Copel assets. Other operating revenues items made up by telco revenue, gas distribution and others grew by 6% and reflect mainly the 31% increase in the telco revenue which comes from the increase in the client base.

On the next slide, slide number 7, we show the operating costs and expenses that were below BRL 2.8 billion in 1Q 2016, 23% less than the one that we had in the same period 2015. This can be attributed mostly to the 33% decrease in the cost with the purchase of energy because of the end of existing energy contracts that were replaced by energy contracts coming from the quota system, much cheaper and the reduction of the Itaipu tariff.

Regarding the other costs, it's important to say that we had higher expenditures with charges for the use of the grid due to the dispatch of TPP's results by the order of merit. Manageable costs went up 12% in the first quarter this year due to higher personnel cost and third-party services due to inflation that reached 10% in the period.

The provisions and reserves line, as I said before on slide 5, represented BRL 121 million was impacted by labor and doubtful accounts provisions. But when compared to the same period in 2015, we see a 45% decrease in the period. But it's important to highlight that in the first quarter of 2015 we posted BRL 73 million in allowance for doubtful accounts related to the difference between the contract of Colíder plants and the spot price, which means a higher amount of provisions at the beginning of last year.

On slide 8, we show the EBITDA that was 37% lower year on year, totally BRL 528 million in the first quarter this year with 17% margin over the operating revenues. The Copel GeT cash generation accounted for 86% of the consolidated EBITDA and Copel Telecom 5%, the other companies in the group accounted for 9% and the main contribution came from Elejor.

Copel Distribuição closed the first quarter of 2016 with a negative EBITDA of BRL 29 million vis-à-vis a positive result of BRL 49 million in the beginning of 2015. But we have the effect we consider non-recurring, because of that we show on slide 9, the comparison between the adjusted EBITDA of Copel Distribuição.

As we know, the tariff for Copel Distribuição compensate for coverage for delinquency that for the current tariff cycle is of about BRL 13 million per quarter. However, the tariff increases and the economic stagnation have been contributing to an increase in the level of delinquency that is higher than the tariff coverage and ended up having a negative impact of BRL 22 million.

The results of the distribution company in this sector decide in a non-recurrent fashion, we posted BRL 38 million in legal claims, provision for legal claims. And in February, we had some organizational adjustments that caused the transfer of part of our fuel cost from the holding company to subsidiaries with higher impact on Copel Distribuição.

Considering these adjustments, the adjusted EBITDA of the first quarter of 2016, which has been positive in BRL 38 million, 58% lower than the adjusted EBITDA of the first quarter of 2015, reflecting very clearly the impact from the market downturn, therefore, the economic scenario that we have in the country now.

On slide 10, we show the consolidated net income of Copel, which reached BRL 136 million in the first quarter of 2016, 71% lower than year-on-year. Analyzing the results of the subsidiaries, you can see that Copel Distribuição posted BRL 39 million of losses in the first quarter of 2016, vis-à-vis a positive result of BRL 29 million in the first quarter of 2015.

Copel GeT ended the period with BRL 165 million net income, 60% lower on a year-on-year basis, whereas Copel Telecom reached BRL 11 million net income, dropping 23% year on year. Specifically about Telecom, it's important to say that the drop that we saw in the quarterly income is directly related to the increase in the financial expense that came from the increase in the debt that's necessary to support the subsidiary's expansion of services.

Before opening for questions, I would like to talk about the leverage of the company. As you can see on slide number 11, the indebtedness of Copel measured by the net debt to EBITDA ratio grew in the last few years, then closed March at 3.3 times. It's important to highlight that this ratio is as planned is below the limit imposed by the covenants that also lower than what we see in similar companies. This increase in the leverage was expected, but it has to do with the significant expansion the company has been going through and will be reduced with the beginning of the cash flows from the different projects that we are building, many of them starting up in the next few months.

So these were now our highlights. We are available to you now to answer any questions that you might have.

Q&A

Operator

Thank you. Now the floor is open for questions. from Citibank.

Good afternoon, everyone. Thank you for the call. Now talking about provisions, ZAR 84 million related to labor claims, could we go more in depth? What was excited that? And do you expect this to continue for the remainder of this year? Thank you.

Thank you. I will give the floor to the accounting person of Copel.

Good afternoon. Referring our positions for contingencies in the third quarter of 2016, in fact, we've had a very non-recurring effects that was the collective lawsuits from specific labor unions that very prudently we applied a conservative approach and basically it represents about ZAR 45 million in our positions. As we hear, our allowance for doubtful accounts is coming up because of delinquency represents a ZAR 30 million 112 as the

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others are the ones that you're familiar with, ZAR 45 million should be non-recurring for the next few quarters, and we're monitoring very closely the issue of delinquency in order to maintain or to go down as much as we can, the amount of provision for that specific end. Thank you.

This is from Credit Suisse. Good afternoon. I have two questions, the first one about provision. We were explained about the provisions regarding expenses that there was a big reversal as well. Maybe, you could mention what it was all about, BRL 50.8 million.

And the second question, how to do shares about the covenant. As we look at slide number 11, I understand that there are many projects that would be coming on stream in the next few quarters. But when we look at the average for the last 12 months, we see a deterioration in generation, although the situation had a negative impact, maybe on the third quarter of last year, as we look ahead. Okay. You have new projects coming on stream, but as we look at the average of the 12 months, generation and distribution worsened. So, do you believe there will be any bell-curve covenant, are you negotiating any of the covenants that you still have?

Good afternoon once again. This is accounting making brief remarks about contingencies. Regarding this reduction, if I understood correctly, these are the last few in 2015 the situation BRL 5 million recurring to the difference of price for the Colíder plant. At there, we have complied with the contracts fully, but there was still a doubt about the price. We only took the full amount and we provisioned the difference of BRL 75 million prudently. Assume as this is judged, we will be able to reverse the provision in the future quarter as soon as we have a decision, a legal decision about that.

Just to clarify, BRL 50 million, you're saying that you have provisioned BRL 75 million for Colíder as you reverted BRL 50.8 million of this amount?

No, no, I'm sorry. I'm sorry, there is some misunderstanding. The comparisons that I'm making is between 2015 through 2016. This is what represented a variation of minus BRL 47 million in our results.

No, my question was about slide number 5. When you talk about the breakdown of provisions et cetera, there are reverted. On slide number 5, was it something specific that was reverted?

Okay, I understand. So in 2016, we have two events that represent the BRL 50 million, BRL 24 million in benefits to employees regarding the Copel foundation and we were able to revert BRL 24 million. And then the other one, which is Pedro as well, of difference in the context of BRL 28 million - almost BRL 29 million, also something on recurrent and that was reverted during this period. So if you add up these two events, we have this difference of BRL 50 million.

Okay, very clear. And the other question is about the covenant.

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Good afternoon. Before Mr. Sebastiani makes specific remarks about covenants, I would like to make some remarks about the results of Copel generation and transition in the first quarter and the expectation for the second quarter.

And of course, it was linked to the issue of covenants, as we have said before I would say that three factors came into play. And they are very relevant in this regard. Impacting the results of the first quarter, the first one was after last year, we had made an allocation of free full energy. This was much stronger in the first quarter.

In this year, we made a more linear allocation over the year. And this tends to show better results as we evolve over the years. And the second aspect was very much impacted also. And this has to do with his first drive with the sensitive recovery and the trend we believe that the trend will continue to be better for the next few quarters.

And they believe there will be more positive impacts on our results coming from the increase in the south side. And then driver and we believe that at least in the second quarter or part of the third quarter. At the end of at the end of the second quarter and part of the third quarter, it will come back online due to the Olympics. So we have a positive outlook for regular trends.

Now, the most important thing have already been mentioned, and worst moment that we see which is the beginning of the first quarter, and that was already mentioned, because of the economic scenario and the specific reality of this sector in work regards for instance to the positive outlook that was mentioned prior. So all that leads us to have a positive scenario for the future.

The covenants are analyzed on a daily basis. All the time we track our covenants, and if you see below the average of the sector and below the average of the covenants that we see and that are only posted at the end of the period. So I understand your concern which is legitimist, but it's important also to clarify to you and to everybody, but we have a permanent monitoring of the covenants and observe being a better scenario from now on for the next two quarters. We have a higher degree of comfort regarding this indicator.

So you expect an improvement in the 12 months EBITDA, offsetting the deterioration of distribution and generation compared to last year, so you believe the situation will not worsen.

No. Our outlook is positive and not negative. We have already established our covenants below the limit and below the average of the sector, and because of all the factors that I mentioned, our outlook is positive as we said.

One last question. The issue of exceeding it, is it only for one quarter or two quarters? Did you have any type of debate?

It's at the end of the fiscal year. That will conclude the merger of the covenants with the contracts that we have in place.

Thank you.

Mr. Marcelo Sá from UBS.

Q - Marcelo Sá

Regarding the volume of energy that you sold, 300 megawatts sold in each year and the comparison with the price curve. So the price curve over time, it becomes more and more difficult to predict the EBITDA for distribution. What would be the recurrent level of EBITDA, can you have the visibility and do you expect an improvement because of the next tariff revision. So how much do you believe the EBITDA will be going up?

A - Operator

This is Lamy. In relation to the sales to commercialization company in 2016, while the generation company showed 2017, 2018, 2019 and 2020. And the amount that we showed, I don't have the exact figures here with me, but we were rather successful the sense of sharing all the energy that we are making available for this auction. So besides having been able to create all our available energy, we were able to reach average prices that are very satisfactory around BRL 128 per megawatt hour. I can send you the exact figures for each year later after this conference about the results of the auction are given to you later.

Just to know the order of magnitude, is there anything that is reasonably significant spot always have been a negotiation strategy. We're taking the energy during over several different auctions during the year, month back, will they see the beginning of value as of 2017 up 200, 250. Just to give you an order of magnitude, okay.

Okay.

Good afternoon. Thank you for the call. My questions were about the covenant and your growth significant volume of energy sold. It was also clear to me, I mean, the volume of energy sold, essentially that at the beginning year having a more aggressive effort allowing the 155 to 130 megawatt hour. Am I interpreting correctly what you said?

Good afternoon. The sound is very bad. So, I would like to ask you to repeat the question.

I had two questions, one about the covenant that you have already answered. And the other one, I need some more color about the order of magnitude of your energy sales of the Comercializadora company. Is it according to the prices that are acceptable between BRL 130 and BRL 125 per megawatt hour, could you clarify this, please?

We had a few auctions in place, in which we sold energy from the generation company, in one modality and Comercializadora in another modality. So, you are asking about the Comercializadora company and because of that, I am going to give the floor to the president of this company.

Good evening. The sales volume of Comercializadora was very concentrated and incentivized and the expectation that we have is attempting around BRL 165 as of 2017. For 2016, the amount is slightly lower, and -- but the purchase is not feasible. Within conventional, BRL 30, BRL 35 is slightly below this amount.

Thank you.

Marcelo Sá from UBS.

I had a question about distribution as the recurring the data. How much it will increase that the implementation of the care revision and it seems to me that 200, 250 average megawatts of energy saved by the generation company is a very high volume, so.

No it's not. It's slightly less than that, between 150 and 200, that's all I have just checked okay.

Now President of Copel Distribuição will answer the question.

Hello, Maria. No, Marcelle, sorry, okay and everybody. About the reduction in our EBITDA, as I said before, it tends mainly from these divisions and also by the problem that we have with the distribution company because the allowance for doubtful accounts because at the moment that because it indeed with recession reduction in consumption and everything trying to do in per annum as in other states, we have been increasing cost of energy and this provoked a reduction in the size of our market and increased delinquency in the consequence our allowance for doubtful accounts we have been working very strongly on our allowance for doubtful accounts even increasing our cuts and also back lifting clients in order to revert this delinquency cost and we believe that this revision with our tariff that you have a trend of change is 10% as of June, we would seeing reversal in this curve, but above that, that was negative this quarter.

I believe that the market will continue to be weak and look at the scenario that we have for this year, we believe we will not even have a BRL 100 million of EBITDA, do you agree or maybe a little bit more than that.

As our CFO said, we have already reached the worst point of the year and now we expect a reverse, we already feel that in terms of delinquency, because we see already reversal in our curve, because we put in place many actions in this regard. And we believe that, the level that you have by the end of this year will depend a lot on what the new administration, the new government does, but we believe there will be a positive trend in the market and reduction in delinquency or the actions regarding allowance for doubtful accounts start.

How much your EBITDA would increase, because of the tariff revision? How much do you expect?

On tariff revisions,

I can say the following that we practically doubled our asset as a consequence, we believe that we will actually double our EBITDA.

Thanks very much. Thank you for the answer.

Miguel Rodrigues from Morgan Stanley.

Q - Miguel Rodrigues {BIO 16533007 <GO>}

Good afternoon. Two things, first leverage, net debt EBITDA that should delivered, is it already adjusted by the CDE and what is the exact balance today going back to the energy portfolio, what about contracts for now - from now on? Are you going to accelerate, expecting prices to pick up or do we intend to have new auctions what is your intention regarding this? New covenants, net debt and EBITDA is not part of that calculation okay.

A - Operator

Good afternoon. This is generation and transmission. Although, we have an expectation regarding the trend or not the trend in the prices of energy from now up until the end of the year. Our strategy, our strategy based on the average price so we're going to hold mainly our strategy and strategy based on the average price. So we're going to hold many auctions starting next month. So we will have many different auctions during the year in order for us to have an average sale price for the year. Okay.

Let's see the market conditions worsen, are you expecting 125 to 130 and if this market price is different from that, are you going to hold back on your auctions.

Our expectation is positive in the sense of having more favorable market prices. Of course if this does not materialize then we will have to adjust the amount of energy to be sold. Due to the market prices, we will increase - we will decrease the pace or increase the pace regarding the market prices and how they develop Thank you.

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

A - Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

This is the CEO of Copel speaking. And we've said before, we had not only yeah could tell that in the sector as a whole and in the country, we had a very unfavorable first quarter the country, which are the very insurable first quarter. We understand that the current factor was even better than the average for the country and our outlook, and we're very much convinced when we say these words is that in the second quarter, we will have that result in the first and closing our debt on this new enrollment that the company started to move and expecting the recovery, because of this change. And we are rather hopeful. We believe there will be improvements in the country and we will be able to close 2016 to the much better perspective than we have in the first quarter. Thank you.

Operator

The conference call about the results of the first quarter 2016 is closed. We thank you for participating and wish you all good afternoon.

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