

Q1 2022 Earnings Call

Company Participants

- Carlos Cyrino, Director of Investor Relations
- Gustavo Estrella, Chief Executive Officer
- Yuehui Pan, Chief Financial and Investor Relations Officer

Other Participants

- Analyst
- Antonio Junqueira

Presentation

Carlos Cyrino {BIO 21090309 <GO>}

(Call starts abruptly) (Foreign Language)

Gustavo Estrella {BIO 18109709 <GO>}

(Foreign Language) First of all, what we are delivering is a very robust result, with a growth of 34.4% results reaching BRL2,643 million, and a net income of 20.9%, BRL1,162 million. Net debt reached -- it's BRL21.2 billion, its growth is especially because of the transmission. But we maintain the leverage, which is 2.3x the net debt to EBITDA.

The CapEx, I think this is another highlight, it's a growth of 74.2% in relation to 2021. We reached BRL1.12 million of investment. We had a concern especially in the beginning of this year due to the pandemic and the effects of Omicron. But we were able to deliver a robust CapEx of BRL1.2 million. An aggressive result, it's an important year for our distributors that are going to have an exception of tariff. So this is an important delivery, and are ready with the challenge of delivering an high CapEx until the end of year.

We also had excellent result with the conclusion of the MTO of CPFL Transmissao. We now control 99.26% of this company. So it's an additional investment -- with the investment that we did in privatization. We practically consolidate the company with impacts that we're not focused, but positive impacts in the consolidation, now almost 100%. And last, we have the release of the sustainability annual report, reinforcing even more ESG practices and the evolution of our commitments, everything that the company has taken over during the last years.

Now, let's move to the next slide, Slide 4. We talk about sales of energy. As you can see here, it's practically stable compared to 2021. A drop in the load of 0.02%, and a drop in the concession area. Perhaps the main highlights here are in the residential area. We can

see here in the bottom right part of the slide, the impact of 3% in residence. This was already expected that we would have a relevant impact of distributed generation in 2022. And this in fact happened in the first quarter. And clearly the trend is that it will happen in the subsequent quarters.

Another one is the industrial area. We can see that we have a drop of 1.8% in relation to 2021. And when we see this in general, we have a positive growth. And this is the [ph]food area, which has a growth of over 5%. This is an important segment for our market with 20% of market share. But when we go to other segments, rubber, vehicles, metallurgy, textiles, all of them with a drop in consumption of 5% to 7%. So I think this is a point of attention.

The performance of the industry, not only for the quarter but for the whole year, we saw a recovery last year in the consumption of the energy. And this year, the market has gone negative, very much linked to the expectation of economic growth, the GDP, and the expectation is a bit lower than 1%. Positive part comes from the commercial side, with a growth of 4.5%. Commercial area directly linked to the improvement of the pandemic in 2022. So in the comparison with 2021, coming from low base in 2021, but important growth, and also with the trend of the commercial side growing more up to the end of the year.

Now let's move to slide 5. This is another concern. During the last quarter, it's the topic of delinquency. As you can see, we have a growth of delinquency not only the last quarter, but also in relation to 2021, a growth of almost 67%. This has a lot to do with two factors.

The first one is the macro-economical scenario. So we have relevant impact in the revenue of our clients, and the impact is much higher in those clients -- in the lower classes. This affects our delinquency a lot. And the debts of the families, the unemployment, all the indicators that reflect the macro-economy affect our delinquency. And added to this, in this quarter, we have the red flag of hydro scarcity with an impact in the tariffs and the bills of our clients. All of this together brings us a scenario, which is very challenging in relation to delinquency.

What we have done? All the actions that the company can do, perhaps the most relevant are the billing. We have kept high cuts, more or less 200,000 cuts per month to try to control this delinquency. But the scenario really is very challenging. And low growth of the economy, GDP 0.7, we will continue having challenges. This is a reflection perhaps of the delinquency that we will have up to the end of the year.

Now, let's go to the next slide, Slide 6. This is good news in relation to energy losses. What we can see here? It's the ability with the trend to drop the level that we've closed at 8.79%. In the past, 9.11%, a more positive signal. Losses is not a huge challenge, I would say, compared to other areas of Brazil. It always is a challenge, but less than other regions, but it's a positive trend compared to 2021.

Now, let's talk about Generation, it's Slide 7. The first impact is the drop of PLD. And here, clearly, this is a reflection of the better hydrology that we have in 2022 compared to 2021.

FINAL

Positive also in the GSF, an improvement of 9%. In the hydraulic, we can see in the HS a drop of 46%. And these are the ones that are located in the Southern part of the country, the flow. And PCH is the inverse, because they are in the Southeast, where we have much better hydrology than in 2021.

Wind, we have a drop of 19% in generation. Here, it's a fruit of the performance of the winds, less winds than in 2021. And the availability as we can see is practically stable at 95.7%. It's a positive result in the availability of the wind farms.

Now, let's go to Slide 8, and then we're going to give the word to Mr.Pan.

Yuehui Pan {BIO 20609514 <GO>}

Thank you, Gustavo. Good morning to everyone. Now, we have Slide 8. In this quarter, we reached the higher EBITDA this year since our IPO in 2019, BRL2.6 million, an increase of 34.4%. The distribution accounted in EBITDA of BRL1.8 billion, an increase of 45.7%. The highest gain, once more comes from the market and the tariffs, BRL553 million, especially due to the IGP-M -- the high IGP-M financial assets. So the concession had an increase of BRL53 million.

Another important effect demonstrated in this quarter, is the value of other revenues that had a gain of BRL26 million. Once more basically from the rental of [ph]Post and also updated contracts by the IGP-M. As a negative effect, we had a PMSO with an increase of BRL43 million. The highest impact of the expense is linked to inflation and increase of 7% below the IPCA, which was 11.3%. PDD was higher BRL36 million, as Gustavo has already demonstrated in Slide 5. Other effects all add to BRL23 million.

In Generation, a very good EBITDA of BRL673 million, an increase of 5.6%. Without the consolidation of the five smaller transmission products, the main positive effect was the updating of the prices of the contracts, BRL147 million. The lower GSF combined to the PLD -- the lower PLD during the period contributed with BRL12 million. On the other hand, we had a negative impact of BRL68 million referring to lower wind generation in the quarter, according to what was explained by Gustav on the previous slide, and a higher OpEx affecting negatively in BRL23 million. Other effects added to a loss of BRL33 million.

Now, let's move to the next slide. Let's talk about Transmission. This was a highlight of the quarter with an EBITDA of (Technical Difficulty)

Carlos Cyrino {BIO 21090309 <GO>}

He had a connection problem, but he's now back.

Gustavo Estrella {BIO 18109709 <GO>}

With an EBITDA of BRL138 million according to expectations of the acquisition of the CEEET, and the effect was the consolidation of the Transmission CPFL number was BRL121 million. The other Transmission projects had a positive impact of BRL6 million. The

Trading, Services and Other segments was impacted mainly by the margin with a variation -- negative variation of BRL70 million. It's partially compensated by Services, BRL12 million.

Let's move to the next slide. We now show the performance of the net profit, which was BRL1.162 billion, an increase of 20.9% in relation to last year. In the result -- financial year, we had BRL311 million. This was because of expenses with the net debt, with an increase of BRL307 million. This has been explained by the increase of CDI, which was 0.48% in the quarter of last year, and now 2.39% reduction in fines, BRL26 million after the adoption of the IPCI and no longer the IGP-M in the delayed bills. This has partially been compensated by monetary update of the regulatory assets BRL117 million due to the higher financial assets. We closed with BRL3.2 billion.

Other effects added to BRL41 million negative. The depreciation increased to BRL47 million, and taxes BRL119 million. The higher value of taxes is related to the better performance of the company.

Let's now move to the next slide. Here, we have the leverage and the covenants criteria. The net debt is totaled BRL21.2 billion, and the EBITDA in the last 12 months reached BRL10.4 billion. The leverage measured by the net debt and EBITDA was 2.03x. In relation to the dividends, we approved in Board Meeting on the 29th of April, the payment of BRL3.7 billion. This amount will be divided into three installments. The first one will be due on the 11th of May 2022, and the value BRL1.1 billion, BRL0.94 per share. The second installment up to the 30th of June of '22, the value BRL0.8 billion, BRL0.67 per share. And the last installment up to the 30th of December, and amount is BRL1.9 billion, BRL1.62 per share.

Next slide. Here, we have the profile of the gross debt. The Higher exposure is in CDI with 69%, followed by IPCA 27%, 62% TJLP. And the chart on the right side, we have the debt cost, which has increased especially due to the variation of the CDI during the period, that went from 8.76% at the end of last year, and now 11.15% in the first quarter this year. Finalizing the end of the -- the cash was BRL4.1 billion with an index of coverage, 0.89x the short-term amortizations. The average time of amortization is three years.

Now let's go to Slide 13. The CapEx of the quarter was BRL1.2 billion, an increase of BRL74.2 million in relation to last year. In the vision per segment, we have in distribution a total invested of BRL975 million, destined to the increase, the modernization and the maintenance of the network and equipments. In the generation segment, we invested BRL62 million in building Cherobim and in the maintenance of the projects in operation. We invested also BRL170 million in the building of our transmission projects and reinforcements and improvements in CPFL transmission. Finally, the Trading & Services segment, we destined BRL5 million,

Thank you very much. And now, I'll give the floor back to Mr. Gustavo Estrella. Thank you very much.

Thank you, Mr. Pan. Well, ending our presentation, we are going to stop -- we're going to end, sorry, with diversity and inclusion. Gender is very much consolidated. With these

FINAL

topics of ESG, social actions, CPFL, a lot of different actions that we have been carrying out in a very positive way, not only internally for our collaborators, but also with all our stakeholders, specifically in relation to diversity and inclusion. I think this journey might be longer, but we are all engaged. It just started. Today, we have a very robust plan with ambitious targets for the next few years. We have three pillars of commitment and governance, inclusive culture and representation, a series of actions, more than 100 actions that have been planned for this year. We have an area 100% dedicated to this area. So over 100 actions that will be planned in 2022.

I brought here an example that we're very proud of. It's initiative of our school for women. And in 2020, we had five women electricians in the company. Today, we already have 29. And the expectation is that in '22, we train another 100 women electricians. So the idea is to continue growing and bringing the women among our electricians.

I think another piece of good news also linked to this topic yesterday in our meeting of the administration board, we approved the Ms.(inaudible). So it is a woman participating on our Board. And I think this also brings the topic forward of diverse and inclusion for our agenda and our governance. I think these are important actions. We're advancing. We're evolving with a lot of clarity, and it's a challenge to advance with this topic. It's a long-term journey, but we've started this journey.

So once more, I thank you all for your participation. We are now going to end our presentation, and we are going to open the session for questions and answers.

Questions And Answers

Operator

(Question And Answer)

Thank you, Gustavo. Thank you, Mr.Pan for your presentation. So now we're going to start session of questions-and-answers and remember that all the questions are live.

(Operator Instructions) So the first question is coming from (inaudible), good morning. Rafael is from Credit Suisse. You can move forward with your question.

Q - Analyst

Well, good morning. Hello everyone. My question, I have two questions, in fact. One is about the transmission assets. I'd like to know in your vision if you have any interest any specific block in the auction that's going to happen in June and what kind of returns, if these returns compare with assets in the M&A market? And my second question is about dividends, if there's any conversation or any expectation of increasing the frequency of the payment of dividends or will it continue annually?

A - Gustavo Estrella {BIO 18109709 <GO>}

Well, we are interested, we are evaluating this auction in June in the same strategy that if it works together with our niche strategy with the transmission assets. I think the concern

FINAL

for this auction is very similar to the previous ones. What we have seen is scenario with a lot of competition, and obviously, the competition fresh is the prices. We have large change in the scenario. If you look at the last 12 of 18 months, we have a scenario today of commodity prices that are higher, scarcity of equipment, pressure in relation to labor. So the building costs of these projects in our vision, they have a different level, not only the cost, but the execution complexity due to the moment that we're going through now. What we saw in the last auction of December, these two challenges were not contemplated. So practically, the level of competition was the same as the previous years.

And this makes the environment very complex, when we talk about the competition. So we are going to participate, but maintaining as we always have our financial discipline, return metrics and order. So if we're not able to be competitive, and if we lose we understand it's part of the game, but we're not going to flexibilize considering the complexity of the execution of these projects today in the current context, which perhaps will be the scenario for the next months. So we have a challenge and the big question is our competition ability in the next -- in the future.

Now as for dividends, our strategy of balance between dividends and growth continues. So we evaluate according to growth and we balance this with the payment of dividends. So I believe that after this evaluation, the effective payment of dividends has a lot to do with our availability of cash flow. Today, we have a cash flow, which is relatively volatile due to the CVA variation that we have now, especially in our distributors. So we have to match the availability of cash for the payment of dividends. We will continue doing this. It's very difficult to forecast the exact dates of payments, given that it depends from of the availability of cash. But the expectation is to maintain our strategy of balancing the dividends and the growth.

Q - Analyst

Thank you.

Operator

Thank you Rafael for your question. Now we're going to move to the second question. The second question comes from (inaudible) from the Santander Bank. Good morning, (inaudible) thank you for your participation. Please ask you a question.

Q - Analyst

Good morning. Congratulations for the results. Understanding all this about the tariffs (inaudible) talked about this question of (inaudible) to amortize how do you see this for the regulators?

A - Gustavo Estrella {BIO 18109709 <GO>}

Well, I think in relation to tariffs is specifically related to this topic of (inaudible) that is something that we already been doing. So I believe that the interest of all the agents of the sector, the regulatory, the government, clients and also companies, I think is to get this tariff amortization in a challenging time through. I showed you the level of delinquency.

FINAL

So I think everyone has to try to amortize the tariffs. This is what we've done without readjustments. We -- this impact is something that we're already doing this compensation and it makes sense that we incorporate this to the tariff readjustments. So I would say that this is natural tendency. I think there's an expectation of the government and regulatory. So I think this will take place.

This discussion of tariffs I think our expectation always goes through dialogue in the first place, chamber, the government, the agency, the ministry, we hear the companies, but we -- the main pillar is regulatory. I think we have a mature regulation. It's already 20 years ever since 2004. So I think it's already mature, understood by the market and that has brought a lot of investment, all the expansion that the sector goes through, goes through private investments. So idea is to preserve this as a center pillar to have alternatives, which is less structural, I think is what we all have to do. I think the big example or a good example of these solutions is the sectorial loans. This is -- this differs the readjustments to the consumer for over a year. I think this is an example, it preserves all the contracts, it preserves the payment capacity of our clients. And I think these -- the types of solutions that we have to work on with all the agents with dialogue and reaching this solution convergence.

Operator

Thank you (inaudible) for your question. We're now going to move forward to the third question. The question comes from (inaudible).

Good morning, Luis. Thank you for your participation. You can ask the question. Luis, I believe you're on mute.

Q - Analyst

Can you hear me now?

A - Gustavo Estrella {BIO 18109709 <GO>}

Yes, we can hear you.

Q - Analyst

Thank you very much. I have a doubt here of delinquency. We see a pressure above historical levels. I understand that you have had the macro effect, but I'd like to know what do you expect for the next months related to PMSO delinquency? Have you seen any sort of normalization? And if you could also comment the expectation of volumes when we look forward? Thank you.

A - Gustavo Estrella {BIO 18109709 <GO>}

Thank you for the question. In relation to delinquency, we are monitoring this periodically and the trend is just to stabilize. We have a very specific plan for our distributors to have higher selective cuts and also with the -- this brings a relief in the tariff and this will benefiting. We notice a small declined this month and we hope that this will remain stable.

And with the recovery of these higher cut volumes, we hope to stabilize. So that's the expectation, stabilization of the delinquency and then medium-term reduction. So we also have plans for installment to make the life of consumers easier and giving opportunity for the clients to make their payments and avoid the increase of delinquency.

A - Yuehui Pan {BIO 20609514 <GO>}

You asked for volume. Talking about volume, we can see that the volume is very stable and we compare to last year, if we look at the expectation for 2022, we see residential a bit low. As Gustavo mentioned, this residential has to do with the habit of people coming back to work at offices. We should see this happen during the next during the next months, a little bit of positive effect of temperature. So we can have volatility, the effect can be a bit negative and we also have the DG. We have the impact of 3% in this demand compared to the demand of the quarter last year, and this impact can grow a bit more during the next quarters up to the end of the year. This is a bit of the expectation here for the residential.

When we look at the industrial side, we see some segments with some demand. This demand can happen during this year. I think it depends a lot on the rearrangement of the supply chain all over the year. We see segments such as vehicles, there's a lack of lack of components, of parts. So you have a weak industry in this first quarter, and it can continue until the raw materials are not received and that these segments strengthen themselves. Once this happens, we have the expectation of growth of this industry for the second quarter end of the year. Of course, it will depend a lot on the macro-economical scenario. But we see in industry some segments are strong like machinery and food. This is strong and we see a positive industry growing in this part of machinery and food. All the pandemic, this remained positive. This continues and this is our highest market share. When we look at the state of Sao Paulo and also the state of Rio Grande do Sul.

When we talk about PMSO, we obviously we having an increase of inflation, interest rates. When we compare the PMSO with last year, for sure we'll see it and we have to look the inflation of the year. So we have a target. We are moving below this target. There's a PMSO below inflation. Last year, we closed and now in the first quarter below the inflation of the period. I think this is our goal when we look up to the end of 2022. It'll be a bit higher than last year due to the inflation and interest rates, but our idea is to continue below the inflation of the period. So nothing too relevant or extraordinary that will affect this from what we can we can see up to now.

Operator

Let's move to the next question. I have a question from Pedro from BTG. Good Morning, Pedro. I think Pedro ended up by leaving. Well, I'm going to move forward to Junqueira from Citibank. Please ask your question and thank you for your participation.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Thank you. Can you hear me. My question is simple. What is the diagnosis of the company referring to (inaudible). If you could share with us what's the big challenge, if there's an institutional solution for? I'd like to know what your opinion is. I understand that in the past

you didn't propose in the auction, but you did in Brasilia, it's another type of operation. I don't know if you have any diagnosis that you could share with us.

A - Gustavo Estrella {BIO 18109709 <GO>}

Hi, Junqueira. How are you? Thank you for the question. Let's move on. I think it's an asset with some challenges. As you mentioned, at the time of the privatization, we were unable to format a proposal to put in the process. So I think after five years, the challenge is similar perhaps in a different position. So I think what ANL did is what should have been done. When we look at the CapEx, it's in fact high, but the fact is that there are two challenges there, perhaps three challenges. The first one is the discussion of (inaudible) that fund for legal issues. We had -- this is a risk that already existed way back. I think now the risk is even higher related to privatization. The risk of the indicators in spite of all the investments, the company still does not deliver some operational indicators and these base for one to reach the concession level.

So there is a negotiation that will have to be carried out so that the company has more time and the institutional relationship, as you said, concessions and we understand the importance of having alliance, a partnership with the governments of states. This has to be built. So these are big challenges and we have a potential of growth. We have all the rural areas, but some challenges are basically the same challenges of the privatization way back in 2017, 2018.

Q - Antonio Junqueira {BIO 15403195 <GO>}

Wonderful. Thank you, Estrella.

A - Gustavo Estrella {BIO 18109709 <GO>}

Thank you, Junqueira.

Operator

Well folks, I think we have ended the questions. We don't see any other questions. So I'm now going to end the questions-and-answers. If there's any question or anyone needs any clarification, if you need anything to do with Investor Relations, we are available to talk to you. So I'm going to give the floor back to Gustavo Estrella for the final considerations and for the closure. Thank you.

A - Gustavo Estrella {BIO 18109709 <GO>}

Well, once more I thank you all for your participation in the webcast of results of the first quarter. I think I would like to highlight two or three points. The first thing is one more quarter, we have a challenging scenario, delinquencies, recovery, et cetera, but I think we've closed with good results. I think the first quarter we have the impact of CPFL transmission with the consolidation of court. I think it's just the beginning. We have a series of improvements in the process of integration that we've been doing and I think it is a contribution with relevant results in the next quarters.

FINAL

Now with the OPA effect and the company 100% controlled by CPFL Energia we trust a lot. The agenda, I think, is very important with all the changes and transformation of the electrical sector, not only in Brazil, but the whole world for us to trust this modernization agenda. And also very important, the maturity and the stability of the regulation. As I said that we've built during the next years, 20 years, is a central pillar so that we can continue advancing in the sector with new investments, bringing new technologies and a service with more and more quality.

So once more, I thank you all for your participation and I wish you all a good afternoon. Thank you very much.

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.

Bloomberg Transcript