Q1 2014 Earnings Call

Company Participants

- Wilson Pinto Ferreira Junior, Chief Executive Officer & Chief Institutional Relations Officer

Other Participants

- Kaique Vasconcellos, Analyst
- Sérgio Tamashiro, Analyst
- Vinicius Canheu, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Thank you for waiting. We would like to welcome everyone to CPFL Energia First Quarter 2014 Earnings Results Conference Call. Today, we have here with us the executives, Mr. Wilson Ferreira Junior, CEO of CPFL Energia, and other officers of the company. This call is being broadcasted simultaneously through the Internet in the website www.cpfl.com.br/ir.

In that address, you can also find a banner through which the presentation will be available for download. We inform that all participants will be only in a listen-only mode during the conference call during the company's presentation. After the presentation, there will be a Q&A session. At that time, further instructions will be given. It is important to mention that this conference call is being recorded.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996 (sic) [1995] (0:01:19). Forward-looking statements are based on the beliefs and assumptions of CPFL Energia management and on information currently available to the company. Forward-looking statements are not guarantees of performance.

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

Now, I will turn the conference over to Mr. Wilson Ferreira Junior. Mr. Ferreira, you may proceed.

Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Good morning to all our investors and analysts. Thank you very much for joining us in the conference call to release our earnings results, and we'll go straight away to our presentation on page three.

In the first two or three slides, I will be giving you an update of the energy - energetic conditions of the system. As we can see, this is the chart we showed in the last webcast. So, we closed the month of April with 43% of our system in terms of reservoir levels in the National Interconnected System. 43.1% today, and the expectations, based on official net power system operators information, we should close the month of May with 42.4%, therefore, below our target compared to the adequate reservoir level.

The bottom chart shows exactly why we are facing this situation. As you can see, this year, basically in the first four months of the year, we had a deficit in natural inflow energy. We are working in one of the worst long-term averages since the beginning we've started measuring this. And this is the main reason why we got to the month of April with an insufficient level in terms of being comfortable to supply energy throughout the year.

Now, obviously because of that, on page four, we'll make some simulations of probabilities regarding how this is going to unfold. In the bottom slide, we can see the history compared to November, when again we'll start the wetter period, the rain period. We are thinking about El Niño and expectation of El Niño. In terms of rainfall, El Niño will give us more favorable rainfall in the so-called wet period in the south. So, it is expected that we are going to have more volume of energy generated. On the other hand, we are going to have a generation deficit in the Northeast.

Because of this forecast, what characterizes El Niño is that the beginning of rainfall will be according to the forecast. In other words, if we do have El Niño this year and probability is high, we can state that, based on the comparison and hydrology with previous years, when we have El Niño, rainfall begins in November, which will be fundamental when we work with the possibility of closing November and closing the dry spell. So, we have two simulations here.

We were careful enough to include, on the right side chart, these two storages according to ONS scenarios. ONS is the net power system operator. And it is all summarized in the footnote of the slide, as you can observe. So that we can close with a 15% storage volume in November, we would need to have a minimum natural inflow energy, ENA, of 84%. On the other hand, if we reach - in order to reach a 30% storage, we would need to have a natural inflow energy, ENA, of 104% that's the goal (0:06:02).

I'd like to remind you that in the last 10 years, as we mentioned in the last webcast, this was slightly below the average of 105%, which we had in the last 10 years. So, this is probable. But on the far right, we can see the level of probability of reaching that ENA. In 81% of the cases, this is possible. So, 19% of this being less than 84%. On the other hand, for an average of 104%, the probability of this being less than 104% is 70%, and only 30% probability of this being higher than 104%.

As requested by the analysts, we also provide you more critical scenario than this, and this is what we see in CPFL scenario. And this is what we call the worst-case scenario. So, as to close in the same levels of 15% and 30% storage in the CPFL scenario, well, this considers a three-month delay in the operation of the dipole of the transmission system of the Madeira River. According to ONS, this is expected to begin in May, and this will bring the major energy – entrant energy volume.

We are also simulating the delay of 400 average megawatts from the wind farms from August to January of 2015. This is a more critical thing. It is more geared to the transmission side of the business. And ONS considers a thermal failure rate of 10%. We're considering an additional failure rate of 5%. And all of that changes these volumes. Not that we're going to have – we are going to have less offering of energy. So, to reach the same 50% (0:08:05), instead of needing 84% ENA, we are going to be needing 88%.

The probability that this will happen is 68%, or the probability that it will be worse than this is 32%. And the same example applies to the 30% storage in November. We would need an ENA of 108% of the average, and the probability of this happening is 26%. The probability that we're going to have less than this is 74%. So based on this table, undoubtedly, we are living in a period of a lot of tension. We need to permanently monitor the situation. Probabilities now are not as favorable as we had imagined.

Just out of curiosity, we are including here the curve that is more similar is the 1971 hydrology curve. This was the worst natural inflow energy in the dry period; in 1934, 60%, and in 1971, 85%. But we can see that the curve in the first four months is more similar to the 1971 scenario than in the 1934 scenario. In 1971, we had 85% of natural inflow energy. In March or April, as you can see, we're doing slightly better than the 1971 scenario in terms of the dry season.

And if we follow the same hydrology of 1971, we would reach, both in the ONS scenario and in the CPFL scenario, 15% and 30% considering permanent dispatch of the thermal power plants during this period, very well. So, this is an update of the scenario. Our recommendation is to constantly monitor and strictly follow-up on these conditions, so that we can get prepared for worst conditions.

Please go to slide five, where we see the highlights for the first quarter 2014. As the market realized, we had an increase in sales in our concession area. I personally have never seen such high values in the residential and commercial segments, plus 13.5% compared to the same period of last year; plus 11.3% in the commercial segment. A positive point is what result from this agreement, the disbursement from the sector fund, CDE, in the amount of R$1,170 million in the first quarter 2014 to cover the involuntary exposure and thermal dispatch.

This was a very high value for the industry, ensuring a high level of liquidity for the Discos. In our Group, Commercialization and Services had an EBITDA of R$77 million in this quarter, higher than all of the value we had in 2013. This comes to show that there is a rally in this market, and the quality and the strategy of CPFL in operating Commercialization and Services. Also, as a highlight in the first quarter of this year, we had a re-contracting of Semesa's energy with Furnas for 14 additional years until the end of the concession period.

The expansion of CPFL Renováveis, here we have to highlight the M&A – the joint venture with DESA, which was approved by CADE in April of this year and by ANEEL in May. And also a highlight is the completion of construction of the last wind complex, Macacos I. There's only one pending item there regarding an authorization by ANEEL, which should come, according to our expectations, during this week.

We invested R$240 million in the first quarter of 2014, obviously, investing lower than usually, recognizing that we need to preserve our liquidity, but not impacting at all the strategy of the Group, particularly regarding the Discos. We are completing our investments in renewable generation, and that's why we reduced the level of investing. We formalized the payment on May 8 of R$568 million or R$0.59 per share in complementary dividends related to the second quarter 2013, with dividend yield of 4.8%.

Economic tariff readjustment, 17.18% of CPFL Paulista; we're going to talk about that. Increase of 16.6% in the daily average volume at BM&FBOVESPA, and CPFL Telecom implementation. It's the first time we talk about that. The creation of a company to operate in this market, particularly in the backhaul segment with 544 kilometers of installed fiber optic networks in the 10 main cities of CPFL.

Now, we are going to give you more detail on energy sales. We have some charts here regarding sales in the concession area. As I have said, 7% increase in sales in the concession area; 9% in the captive market and 1.9% in the use of our Distribution System, TUSD, so a combined sales increase of 7%. In the middle table, we can see here the sales by consumption segment. Residential and commercial, as you can see; commercial practically flat – industrial is practically flat, a slight decrease, but we have commercial growing 11.3%, others 11.6%, totalizing 15,507 gigawatt hour.

Okay. Sales growth in the concession area had an 18.9% in energy sales by CPFL Renováveis, a drop of 11.9% in the volume of Commercialization and Conventional Generation, giving us a total energy sales to consumers increasing 4.1%. This can also be observed in the bottom chart. CPFL grew its distribution companies operation above what Brazil grew; 6% for Brazil, 7% for CPFL. That is notably due to the growth in the Southeast region. CPFL grew 6.2% against 5.3% Southeast growth, maintaining our 11% commercial-ability.

Trying to explain this effect of the market, on page seven, we have some of the explanations. We can observe here, in the first quarter, we had growth particularly of residential and commercial segments, 12.7%. Brazil grew 10.3%. CPFL grew 12.7%, in blue. We can see the main increase happened in February, so there's a decoupling; 19.1% for CPFL, 14.6% for Brazil. And the main reason is temperature.

If you look at the bottom right-hand corner chart, we are going to see the breakdown of consumption. Because of economic growth, the economic effect in green, we can see the – we can account for practically half of these values. But in light blue, we can see the temperature effects. In other words, the temperature effect is what justifies this higher volume. And we'll see both in the top chart, the temperature, we can see deviations.

Campinas is the city with – where we have our largest concession, 32.7% deviation from historical average. Caxias do Sul, the biggest RGE city, 26.3%, and some other cities there you can see with deviations of 15% or 10% above. And accumulated CDD, cooling degree days, in the first quarter, we can see that we had 715 degrees higher. It is the sum of all of the temperature and its effect.

And this was in the first 90 days – in the first quarter, right. So, this is the sum day-by-day of the value that corresponds to the positive difference between the average daily temperature and the threshold of 18 degrees. So, these temperatures were indeed higher than historical values, and that's why we have these deviations from historical average. And this accounts primarily for this increase in consumption.

To have a better idea of what is happening, please go to slide eight, where we have the profile of residential consumers of CPFL Paulista and CPFL Piratininga in the State of São Paulo. And we can see that 23% refers to the refrigerators and freezers; 13%, electric fans and now more recently air conditioning equipment. And the consumptions, if we look on the right side of the slide, the consumption of refrigerators and freezers practically doubled – actually more than doubled compared to winter time.

And I explained this in the past webcast; because of the difference in temperature, we have to maintain a constant inner temperature and we have the compressors working for longer. And the same goes for electric fans and air conditioning. There's practically no air conditioning and fan consumption in winter. So, we see 183 kilowatt hour in winter time, increasing into 237 kilowatt hour in the summer. And this is a lot higher when we have important differences in consumption. Indeed, the refrigerator consumes about 2.5 times higher consumption than in winter.

Now, let's turn to slide number nine, where we share the results for the first quarter of 2014. As we usually do, on the first line, we have IFRS results, and in the second line, we have what we call managerial results; IFRS added to the proportional consolidation for generation, and also we have the regulatory assets and liabilities and non-recurring items accounted for. So, under the point of view of IFRS, we have a variation there of an increase of 8.2% in net revenue, a drop of 25.4% in the EBITDA and a drop of 57% in the net income. And we'll talk more about it.

I always like to do the comparison with the managerial results with the recurring results of the company. I would say that they are truer in terms of volume of assets, and it makes it easier for analysts to work with these figures. So by those results, we had a stable growth. We had the EBITDA – and remember that this quarter, we had the comparison to a tariff review from the largest distributors in the Group, and we'll talk more about that as well. On the other hand, the operations of Commercialization and Generation are also included.

And in the net income, we have a drop of 7.9%. That was due to the indebtedness indicators of the company. There was an important increase of the CDI in the quarter. So, I would say that in the EBITDA, we have stability because we have Generation and Commercialization offsetting the drop in Distribution. On the net income, we have worst results due to the indebtedness conditions. These were the main reasons for the variations.

On the bottom part of the slide, we have the breakdown of all the figures on the first line. We have the proportional consolidation of generation. And let me remind you that here in the IFRS, we don't have a full integration. We consolidate basically (0:22:04) participation. So, this consolidation is necessary to EBITDA. We have the regulatory assets and liabilities, and last year especially that – we had an agreement with CDE, and so last year, we also had that coverage of the biological risks, and we don't have that this year.

So, the figures express that something that hasn't been done in January of this year besides the hydrological risks, and the comparison of non-recurring events, we have legal and judicial expenses that we had last year. And last year and this year, we had exposure to MRE in the first quarter of last year and this first quarter. It was especially related to CPFL Renováveis and its projects. And then we have smaller figures for reallocation of costs with basic grid losses, also effective tax PIS/COFINs adjustment, and also the write-off of Epasa's assets that happened last year in that plant.

This would add in the comparison of IFRS and also add in the managerial amount, from R$787 million, we would reach R$1,086 million. And that explains that a lot of this variation is due to regulatory assets and liabilities should have those impacts, and we do have the proportional consolidation. Let me try and explain on page 10 these effects, especially of the CDE coverage through monthly disbursements by sector. And on page 11, you will see that we have had R$9.2 billion coming into the sector. And you can see that in January, we had from CDE R$1.2 billion just to cover the voluntary – involuntary exposure.

Part of that, R$181 million that we mentioned of regulatory assets of our distributors, we didn't have coverage of that additional dispatch for thermal. From February on, after the 221 Decree, we have here the coverage of this involuntary exposure for R$0.2 billion, plus R$0.92 billion (0:24:42) of thermal electric. And in March, R$2.3 billion for involuntary exposure and R$1 billion for thermal dispatch, and that adds to R$9.2 billion. And remember that we had the disbursement for this operation R$1.2 billion, and right after that, R$11.2 billion, adding R$12.4 billion. R$9.2 billion have already been used just to pay for those additional expenses in the first quarter. So, we still have R$3 billion or something around that.

It's important to show this analysis that we – that this was a successful auction, the A auction. 2,046 average megawatts were contracted and what we had declared by the Discos in January was an exposure of 3.6 average gigawatts. The estimated deficit due to seasonality of consumption of distributors was of 2.4 gigawatts. So we reached 2.46 gigawatts, a coverage of 85% of all needs up to the end of the year. Obviously, this is at a higher price changing from R$262 for thermal and R$271 for HPPs.

On page 11, we can see the impact on CPFL. We have received R$1,170 million, and here we have average 200 megawatts of exposure. We had in the auction 257 average megawatts. And for May on, we are very comfortable, because in the total sum of the Group, we are doing well. But this is a Group position. So, we have a long position in Piratininga and short in the other distributors.

And also I would like to highlight here the tariff adjustment of Paulista, and considering a spot price of R$632 megawatt hour, and that shows how real this is in terms of future exposure, the exchange rate to R$2.34, IGP-M 7.3%. The CDE quota would add R$430 million. There was a reduction of that disbursement for R$145 million. That's why we had a lower increase than the initial one, because we were using a previously-established quota of R$450 million and that quota was reduced.

We also have ESS and EER charges of R$152 million and the CVA 2013 transfer of R$173 million. Because of that, the Parcel A increased 17.4% and B Parcel 6.54%. You can see that the tariff increase is basically due to the increase of energy in Parcel A that has this impact of 17.4%, where there's a tariff impact of 12.84%. And that this exclusively due to the amounts updating above tariffs in terms of energy bills.

Now, let's turn to page 12 and I'll go into the breakdown of the company's EBITDA as well as net income. As I have said in terms of the managerial, we have - went from R$1,081 million to R$1,086 million, 0.5%. So, I'll bring you the details. To your left, we have the regulatory assets, we have non-recurring events and the proportional consolidation, as I said before. And here I am bringing you the details of the 25.4% drop in IFRS from R$1,055 million to R$787 million. So, that is explained by net revenue of R$282 million increase. And here, there's a positive highlight, which is distribution that has two elements.

One element is the one that we have just detailed that the market mix of volumes, as well market volumes, because we have average tariffs that are better than the industry. So, we had a gain there. But we had a negative effect for tariff due to tariff review, especially Paulista and RGE, that happened last year. Therefore, they were not there in the first quarter. So, we are using these two effects, the tariff review that accounts for 75% of the distribution activity in the Group. And on the other hand, we had better volumes especially due to temperature effect on the economy in this first quarter.

We also have due to the seasonalization a Conventional Generation increase of R$30 million in (0:30:38) CPFL Renováveis, we had new undertakings coming in along last year. So, we have an extra R$30 million. And the Commercialization and Services activities, we had lower revenue. But you can see that this drop in revenue was R$44 million. But we had energy sales at more competitive prices. So, we do have a drop of R$105 million. So, the revenue is coming down 44%. But we were able to have broader margins, and we'll talk more about that.

So first, an increase in revenue; second element, the increase of cost of energy, R$651 million, already net of the disbursement of R$911 million. So, here we are talking about an increase of R$1.5 billion or a little bit more than that. So obviously, we see that that increase of R$730 million of the - in the energy bills at the distributors. For CPFL

Renováveis, we had a delay in the undertaking. We had an exposure specifically here for (0:31:55) that was contracted from the April 1 on.

And then Commercialization and Services, I just said we acquired energy R$105 million cheaper than last year, and in the Conventional Generation, R$17 million. So, the element that is determining here is that we increased revenue R$280 million, but we had an increase in costs due to purchasing of energy. And we had a small decrease in operating costs and expenses, R$20 million (sic) [R$28 million] (0:32:30), a 5.8% decrease.

We have non-recurring effect here from last year. Those legal and judicial expenses from last year, they are non-recurring. And the other ones are recurring. A drop of operating costs in Renováveis is R$3 million, also third-party services decreased R$5 million, and an increase in Others for R$28 million. We had an increase with personnel there of R$13 million due to Collective Bargaining Agreement. PMSO Serviços in R$11 million.

So adding all that up, we have the equity method for the consolidated, Foz do Chapecó, Barra Grande and Campos Novos, with R$65 million, and that is under the equity method. And these are also under the tariff reviews for those gencos. And the private pension fund activity that had a drop on R$8 million vis-à-vis last year. So basically, we have an increase in revenue in 8%, a cost – increasing energy cost which is a very typical situation that has to do with PLD and thermal energy, and on the other hand, we have a reduction of 5.8% in operating costs and expenses. And that explains our EBITDA variation.

In the next slide, we did a comparison of an important process of cost reduction for the last two years. In actual amounts, we have dropped almost 4%, exactly third-party services from R$118 million to R$104 million. In nominal figures, as I have said, a drop of a little bit more R$5 million of R$111 million to R$104 million, and that explain the variation of our PMSO. Those R$10 million nominal is what we have in terms of nominal growth and R$13 million of real or actual reduction when we did that comparison.

Now, turning to page 14, let's do an assessment of the net income. As I have said, in managerial basis, we would have a drop in 7.9%, R$429 million in the first quarter of last year to R$396 million for this quarter. Taking away the non-recurring effects and regulatory assets and liabilities, we have then a drop of R$405 million to R$174 million comparing the two quarters. The first one we just detailed, a drop in 25.4% in the EBITDA of R$268 million.

The second one, which is the worst about our financial income net, we have R$65 million (sic) [R$69 million] (0:35:38) loss exactly due to the increase of debt charges. And you can see in the upper block over – of our indebtedness as indexed by the CDI. In the first half of this year, that is 9.9%. So, that explains the increase of the debt costs. We also had the mark-to-market of the Law 4,131. It was of minus R$26 million, and we should recover that in the funding.

And different variations or smaller variations of minus R$11 million, and the financial update of discos' financial assets in R$27 million positive. We had 6.8% increase in depreciation and amortization of R$18 million. And also income tax and social contribution, considering the lower results, we had R$134 million less of income tax and social contribution than we had last year.

Very well, now I'm doing assessment per segment. It's important to follow-up the segments individually to make it easier for you in the analysis process. So on page 15, we have the bottom line here. Distribution, an increase of 7.3% in revenue or net revenue. 19.4% lower EBITDA. So, that is already integrating and acknowledging - accounting for all the effects of tariff review. And the net income drop of 28.5%, because the CDI is more applicable to the Discos. So, some highlights, the increase of 7% in volume. The implementation of 3rd cycle of tariff review has a negative effect, as I said. And we have R$10 million in assets write-off for PMSO, as I already said.

We have to now look Conventional Generation and Renewables, increase of almost 35% in net revenue. I think here we have two major impacts, the new assets in Renováveis and new liquidity prices for energy generators. And this has a positive effect in the EBITDA reaching 25.3%, R$506 million, and a net income of R$156 million. Remember that genco is financing TJLP, that is in long-term, and we did not have much variation there. So, the positive impact that comes from the EBITDA is expressed in the net income.

And in Commercialization and Services, as I have said, there is a drop in 2.3% in the net revenue, reaching R$553 million, vis-à-vis the same quarter of last year. But the EBITDA increased 257.8%, R$77 million, a very positive quarter. And I believe it reflects the operations coming back for CPFL, and on the line of little leverage activity, we have the same figure, free of income tax, is almost - was R$51 million. I believe this is a positive quarter for generation of renewables and Commercialization and Services.

I'm not going to say it's negative because it's happening at every five years now specifically for CPFL, and it reflects from one year to another the drop of results due to the tariff review. And here, we have our homework to keep on reducing costs or managerial costs to be able to mitigate those effects. The positive aspect here are reviews that are very close to our expectations, to the market expectation, and here we see an opportunity due to the size of the Group's capacity and the instruments level, whether ABD (0:40:15) or shared services. And especially now, with (0:40:20) coming in for Discos, I believe we have a positive perspective to mitigate the results.

Please turn to page 16. We are going to talk about our indebtedness. Stable leverage, an indicator of 3.58, R$12.8 billion in debt, given the funding strategy of the company. We closed an adjusted EBITDA of R$3,570 million. And the highlight goes to the CDI increase and impact on the total cost of the debt, 8.4% increasing to 9.1% (0:41:00), and this has an impact, increasing from 8.4% to 9.1%, and 2.4% increasing to 3% in TJLP.

And we can see 68% CDI, 22% TJLP, 7% prefixed PSI. 2.5% and 3% is recognition of the debt indexed or pegged to IGP. We closed the quarter with this cash and - with R$4,243 million cash coverage. And we are now on slide 17. And then average tenor of the debt a little over four years. Short-term debt, only 8.1% of the total debt. So as you see, we enjoy a very comfortable position in terms of the financials and cash position of the company.

On slide 18, we talk about generation activities. Highlight goes to the Macacos wind farms that have been completed. Turbines' assembly have been audited by the agency. We are only awaiting ANEEL's resolution, which we expect for this week. It is a 78 megawatt project, R$161.5 LFA per megawatt hour. And now, we see another three projects of the company, two to be delivered in 2016; Campo dos Ventos wind farms and São Benedito wind farms. And we can see 82 megawatts plus 172 megawatts. And Pedra Cheirosa wind farms, which is what we were awarded in the last A-minus auction, 51.3 megawatts of installed capacity.

On page 19, in the next two slides, I would like to mention about this initiative of creating CPFL Telecom. It is an activity that allows us to have one more opportunity to create value. I'd like to remind you that the telecom market is in full growth. It grew a lot, 4% last year, with investments of R$26.5 billion with important growth drivers; Anatel putting pressure to push the quality of 3G, 4G deployment, broadband expansion. We have important deficits in this area, which translate into opportunities for new entrants, i.e., the world scenario redirects global players CapEx.

And the telecom's long-term future is more intense in data traffic and fibers. And there is an important government plan to make relevant investments in telecom infrastructure. So we are talking about a number of growth drivers to lead us to this market. And CPFL has a number of competences, which in our assessment allows us to create value in this market, either because we already have a good grids coverage (0:44:33). We have rights of usage and we are a neutral player in the market.

We can be attractive for any telecom operator that needs to grow and expand their services in CPFL's concession area. We have a good know-how for grids deployment. We provide a lot of services through CPFL Serviços, and we have the technology that also provides the basis for our automation projects for the power grid and smart grid. So, it is a positive combination of our competences with the current momentum of the telecom market.

On slide 20, we have the characteristics of the assets that we're putting together to operate in the telecommunications market, what we call, Metropolitan Optical Grids backhaul. To make a comparison here with the power system, backhaul is the distribution activity and backbone is the transmission activity. So, we are positioning ourselves in the backhaul side of the business with these Metropolitan Optical Grids, which allows the grid to be used by the operators to have access to customers. So, we meet the demand for infrastructure and capacity of the operators who need to have this capacity in fibers, just like this drawing here shows.

And where are implementing our strategy? Well, we made an evaluation and we identified a number of cities in the city of – in the State of São Paulo, 42 are the most economically attractive cities with a greater concentration of users. In these selected cities, we have 7.3% of the Brazilian GDP, of a telecom market estimated to be R$13 billion per year. So it is an important opportunity. We divide our action into two phases. Phase 1, which we will complete along the month of May, we would be accessing or making this infrastructure available to 17 cities, a total of 649 kilometers of optical cables.

In Phase 2, another 25 cities, a total of additional 680 kilometers of optical cables. In April, we have 544 kilometers of cables deployed, 10 cities being served. We have signed our first contract with one of the operators, a contract that was entered last month. And now, we start the commercial activity of our Phase 1 to serve operators that need to use our infrastructure. And we are quite optimistic regarding the results of this activity looking forward. We will be following the situation of this activity in the coming webcasts.

Please go to slide 21, just to say that we are performing a little bit better than IEE in New York. Because of exchange – foreign exchange conditions, we are doing slightly better than Dow Jones Index and Dow Jones BR20. Our share performance followed these indicators. The highlight goes to an increasing volume, either in trading volume of about 60% increase and in terms of daily volume trade reaching – that was up 16.6% reaching R$44.4 million.

With this, we finish – we end this presentation and we remain available for questions.

Q&A

Operator

Ladies and gentlemen, we will now begin the Q&A session. Our first question comes from Sérgio Tamashiro, Safra.

Q - Sérgio Tamashiro

Good morning, everyone. Wilson, I have a couple of questions. Starting with generation, you mentioned the strong results of generation, the generation side of the business, particularly conventional R$50 million, renewables another R$30 million. So my question is what can we expect for the coming quarters? What's going to happen with these results? What GSF are you imagining for the coming quarters? And in this breakdown, distribution has an EBITDA very similar to that of generation. So, in the long-term, we are looking at 2015, looking at a more normalized situation, what could be the EBITDA mix in terms of generation, distribution and commercialization?

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Hello, Sérgio. Thank you for the question. As for the seasonality effect, we understand that this is a permanent effect. We are covered for the second quarter. So, the seasonality effect is permanent, will remain throughout the year. Now, as for GSF, that's different. We work with an expectation of average values during the year. We could reach 6% to 8% (0:50:22) and this has an impact. We cannot yet pinpoint, but CPFL is the best. The contribution of CPFL in MRE is almost 1.5%.

So, our impact to sales by (0:50:51) GSF is quite reduced. But undoubtedly, this is a risk that we have to manage looking forward. As for the results and the expectations of results for the company, we had this quarter in distribution – we also have effect of so-called tariff review cycle. We now have five years where we expect to gain efficiency and have market gain. Undoubtedly, the distribution results will continue to be superior to that of generation. This is our flagship in terms of forming the EBITDA.

In gross numbers, we are talking about an EBITDA – it would be slightly over half coming from distribution, and the other remaining half, it would be basically 40% coming from generation and 10% coming from commercialization and services operations. This would be more or less the EBITDA mix. We expect EBITDA to grow in distribution either because we higher efficiency for market conditions, or in the case of IFRS, due to the re-composition of the tariff for what was not covered by loans or by CDE. And this is what we are considering. We are – this will be offset in coming years.

Q - Sérgio Tamashiro

Going back to seasonality, at least the way I understand this, you had considered seasonality more in the first quarter. You left more energy available to be sold in the spot market, and now in the coming quarters, you will need to offset that. In other words, now you will have to purchase energy in the spot market and have less storage for the coming quarters. In other words, you won't be able to keep the strong results of this first quarter. This result would be reversed.

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Perhaps the highlight is that we purchased energy to cover for seasonality, and we are comfortable with this energy purchase. In terms of the gain in the first quarter, it will be maintained, not for GSF.

Q - Sérgio Tamashiro

Okay. But energy purchase for the coming quarters, did you do it this year or in previous years?

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

We did this in the beginning of the year. I haven't got the price here, Sérgio.

Q - Sérgio Tamashiro

And another question about distribution. You mentioned that the main factor contributing to growth in distribution was the temperature – higher temperatures. What about employment and income? So, excluding the temperature effect, what could we be using in our growth modeling for 2014 and beyond?

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Growth is 4% – 4% or 4.5%.

Q - Sérgio Tamashiro

And this year?

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Well, this year, it was 4%.

Q - Sérgio Tamashiro

Thank you.

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Thank you for the questions, Sérgio.

Operator

Our next question comes from (0:54:50).

Good morning to all. I have a question about the telecom business. Actually, I would like to understand how the revenue is going to be recognized and if there's going to be any offset in the tariff, so as to maintain low tariffs for CPFL customers, because in the current regulatory framework, if you're using the Discos, you end up having to give something back in discounts to consumers. So how are you designing this? Can you split fiber optics from the distribution grid, so you won't have to give this back as low tariffs. And perhaps, it would be better to wait for the definition of the first cycle to perhaps get into this business with more assurances that you're going to have the adequate return.

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Well, Marcelo (0:55:47), CPFL Telecom is a company with its own corporate taxpayer number and authorization to operate awarded by Anatel. Other companies could have done that too. And it pays the rent to the distributor - distribution company. Now, obviously in the process of sharing gains, this is exactly what it pays to the distribution company. We participated in competitive bids, and just like any other company, it uses the infrastructure. In its business plan, there is no need to share its revenues with the consumers, only the expenses that are related to the use of the infrastructure of the Discos are shared.

Q - Operator

Okay, understood. Thank you very much.

Our next question comes from Mr. Vinicius Canheu, Credit Suisse.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Hello Wilson, thank you for the call. My question is about distribution. You mentioned that, now that you had all the reviews, after the reviews - it's already time for the next one, so at least to start a new cycle. ANEEL, last week in an event, they said they intend to disclose the main targets for the next cycles in the next two or three months. So, I would like to know what the market can expect, in a very realistic manner, in terms of changes that we'll see now on the fourth cycle. Can we see any relevant change in the capital cost, any different – anything different about the company? So what is CPFL's view about that, considering what we have seen in the last two or three cycles, which was a pressure in the distributor cash and to transfer that price to consumers?

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Well, we have a positive expectation about these new rules except – well, whether because of the profits and a long integration process with all the agents and that has been happening already. And the profit itself of opening to anticipated contributions and to have a longer period of changes for the second half of the year, that shows more maturity on the part of the agency regarding those processes. So, in terms of processes, we did have advancement. Maybe the two important things are how things are happening and with a whole set of interactions.

It's always difficult to talk about expectation, but I'll risk myself. When we analyze the company's results and the comparison of the quarters, you can clearly see that – well, maybe in the past, we didn't have a whole set of tools to establish PLD or the spot price. And I believe that we can talk about at least with R$630, because we have had already in that mix different effects and we were able to maintain all procedures. And that was simpler for the agency to establish the figures. And that will bring a lower load of CVA in the future when we have a more organized process. I believe we are starting on that and we consider it a favorable trend.

Second favorable expectation has to do with WACC. In the last cycle, it had an impact, I believe, for many companies, not CPFL. But they are having problems with liquidity. And in specific moments like that when we have the CVA, operation might become unfeasible to CPFL as a Group and we have a better condition to export. But as a distributor, we just take the same hit in terms of cash costs. But whether by the financial statements – and maybe you analysts can have a clear vision of that, because these contributions are important, the cost of own capital and the cost of investments.

So, you can see that clearly that we went from 6.5% of CDI and went to 9.9%. And all this said, now talking about the downside, I understand that should be acknowledged by the regulator. Here, we have to acknowledge what is really happening. So, there is an increase of third-party capital cost and own capital as well. And if this is not acknowledged, the investments in these areas will be compromised and that is not adequate for the regulator.

So, besides these improvements, we have a whole set of rules that have to do with the transfer of the, what we call, the civil year (1:01:18) and the tariff year, and we have best values in that year (1:01:26). And then we are working on it in a non-regulated way, and we understand that there's acknowledgement of non-forecasted costs or purchase of energy and charges that they will also have a more precise management considering the tariff year instead of the civil year (1:01:51). I believe there is a set of important discussions. We have advanced already in terms of the costs – operating costs matter. These are small improvements.

And I believe that we also have to expect an improvement in processes regarding the accounting of the regulatory remuneration basis. I believe that a whole set of simple measurements, as it has been done in the last cycle, it has generated undesirable effect because it's not adequate that you have a regulatory balance sheet and an economic balance sheet, because we have difference in terms of the investments, especially because some of the write-offs due to the non-recognition or non-acknowledgement of that expenditure as an investment, it would have been booked as expenses, and that amount should have gone back for operating costs. So here, we do have a law and we have room for improvement.

Actually, the ideal is that we have incentive for investments and for the acknowledgment of investments as well, because it does bring benefit, and that simple approach process, because the process is too complex. And I believe the accounting will turn the process into a more transparent one. And maybe this word transparent is the one that adds – besides what we are discussing here, transparency has to be the purpose of the agency. So that the tariff review process does not become a surprise, so the review amount as what is expected by the market, by the operators and by the agency itself. If we do have a large difference in expectations here, then I believe we do not have a positive process if that happens. So, I think that the convergence of the final results of those assessments will turn this process valid, that's seasonality and in transparency.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Okay, it's very clear. Thank you very much.

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Thank you.

Operator

Excuse me. Our next question comes from Mr. Kaique Vasconcellos, Citigroup.

Q - Kaique Vasconcellos {BIO 17317373 <GO>}

Good morning, everyone. You had a strong result in this half of the year, so you had higher margin. And what kind of performance that we can expect for the segment for the end of the year?

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

You are talking about the commercialization?

Q - Kaique Vasconcellos {BIO 17317373 <GO>}

Yes, exactly.

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Well, I will ask Claudio (1:05:07) – he is the commercialization area CEO, and he can bring you more information. But our objective here in higher risk operation is to work with planning and to sell at a higher price than the price we purchase at. Claudio (1:05:31) and his team in this quarter were able to make it happen, and I believe he can bring you more information on it.

A - Operator

Obviously, we had a strategy in terms of seasonality, higher prices in the first quarter that was expected in terms of our strategy. And I'm sure that up to the end of the year, we also have good perspective for the commercialization area. As it has been said in the first (1:06:01) quarter, we have met the target of the EBITDA for 2013 (1:06:05) and we have a positive expectation of course with a higher spot price. And we also improved the results of the first (1:06:15) quarter, but we have good expectations for the next month as well.

Q - Kaique Vasconcellos {BIO 17317373 <GO>}

Thank you very much.

Operator

Excuse me. We are now concluding the Q&A session. I would like to turn the floor to Mr. Wilson Ferreira Junior for his final remarks.

A - Wilson Pinto Ferreira Junior {BIO 20013669 <GO>}

Okay. Once again, I would like to thank you all for participating on this earnings results call. I would like to say that, at the CPFL Group, we feel that about the operations – and I'll make a brief summary here. We are focusing on the cost management process that has a positive impact on distribution activities. I believe it's important to highlight that, in generation activity, the conclusion of projects, especially CPFL Renováveis, we focused on the last two quarters and that is due to the exposure we have. We ended up having delays for two large projects in the company.

This is a concluded situation. Everything was solved. We have transactions and accountabilities that will be worked on with suppliers that some way caused the delays. So, we do have offset instruments, but not from now on. Now, we have a full mature operation with an M&A transaction that should be concluded in the next month. In 60 days, we believe this is going to be concluded. And in Commercialization and Services, we are long. And from now on, that also brings us favorable expectation about the scenarios with good results on it.

That is the positive – the good side. Now, everything that we should pay attention to, two main topics. First, on the energy point of view, we are in a very sensitive moment. We have to constantly monitor it, to pay attention. And we know how important this matter is to the government and how close attention the government has to pay to the matter. And we all have to manage this very sensitive moment.

And also important, this perspective of El Niño; for us, on one side, that represent additional volumes of generation in the south, a better hydrology in the south that's going to happen now. And on the other side a certainty level that we are going to have the Southeast rainy season starting at the right time, and that really shows a better probability of the phenomenon happening. On the other hand, we are living with that liquidity in the sector that happened to operations whether from government CDE or loans, and we have a remaining amount on the account which is needed for April.

And obviously, when we develop the system, we need to keep on using the system. And we know that the offset of the 85% of the exposure, I would say that largely we will need extra funding. But that shouldn't be too high, but we will need that. We have covered already 85%. And this is an important perspective. I would like to highlight the initiative of this job generating a market alternative, so that we can have an adequate level of liquidity in the energy system coming from distributors.

So in summary, I want to say that we are very positive in terms of the Group's strategy and the Group position vis-à-vis its operations. And on the other hand, I would say that we should really pay attention to next months, once they will be very important especially in terms of the energy monitoring. But I believe we are able to face this new challenge. I believe it has been positive already, because we had improvement whether in the regulation allowing for a new solution, whether in other process with the agency, as we talked about the tariff review, so that we can have a higher sustainable level in the sector from now on. These were our final remarks. Thank you very much for your attention.

Operator

That concludes CPFL Energia audio conference. Thank you very much for your participation and have a nice day. Thank you.