

Q3 2019 Earnings Call Portuguese

Company Participants

- Fernando Mano da Silva, Chief Executive Officer and Financial Director, CPFL Renovaveis
- Gustavo Estrella, Chief Executive Officer
- Luis Henrique Ferreira Pinto, Chief Regulated Operations Officer, Distribution Segment
- Yuehui Pan, Chief Financial Officer

Other Participants

- Gustavo Miele, Analyst
- Thiago Silva, Analyst
- Unidentified Participant

Presentation

Operator

Good morning. Thank you very much for waiting and we would like to welcome everyone to the CPFL Energia's 3Q'19 Earnings Conference Call. Today with us we have Mr. Gustavo Estrella, CEO of CPFL Energia; and Mr. Pan CFO and Investor Relations Officer; as well as other officers of the company.

The presentation will be available for download at the company's website, cpfl.com.br/investor-relations. We would like to inform you that all participants will be in listen-only mode during the conference during the company presentation. Afterwards, there will be a question-and-answer session when further instructions will be given. (Operator Instructions) It's important to mention that this call is being recorded. Before proceeding, we would like to mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996.

Forward-looking statements are based on beliefs and assumptions of CPFL Energia's management and 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 they depend on circumstances that may or may not occur.

Investors should understand that general economic conditions, industry conditions and other operating factors may also affect the future results of CPFL Energia and may cause results to differ materially from those expressed in such forward-looking statements.

Now, we would like to turn the conference over to Mr. Gustavo Estrella. Mr. Estrella, you may proceed.

Gustavo Estrella {BIO 18109709 <GO>}

Good morning, everybody. I thank you very much for your presence in the third quarter of '19 conference call. Let's go to slide number three of the presentation with the highlights for the third quarter. And the first two ones refer to our result, the EBITDA reached BRL1.618 billion, a growth of 4.5%. Our net income BRL748 million, growing by 19.4% and later on, we will see that from the view -- we have not seen a recovery of the consumption of energy, but the results are good and EBITDA and net income lines, our net debt was BRL16.8 billion, with a leverage of 2.68 times our net debt-EBITDA ratio.

Here already considering the acquisition of CPFL Renovaveis' shares that occurred in the first half, 99.94% already consolidated under the CPFL Group. One important highlight has to do with the investments. We invested in the quarter BRL616 million, a growth of 17% vis-a-vis 2018. And we continue delivering the investment of BRL2.2 billion during the full year of 2019, on this track a very good news. Have to do a tariff review of CPFL Piratininga, we'll be talking about this entity later on, but the final effect is a negative adjustment of 7.8% for our customers and increased in 6.2% in Parcel B and the effect is the transfer of the loan of CCEE and this causes this important drop in the tariff and this is very important for our customers.

As I said before, we have already finished the transfer of shares of CPFL Renovaveis, BRL4.1 billion being paid and the value per share BRL16.85 and the process has already been concluded. So we have Renovaveis almost a 100% integrated into the CPFL Group and with that, our installed capacity for generation is 4.3 gigawatts, already considering the new participation of CPFL Renovaveis. We also had an important recognition on the Exame, the sustainability index as the most sustainable company in the area of energy, highlighted the CPFL at the hospitals program by means of which, the program with energy efficiency program. We will have BRL115 million being invested over the next three years in order to have solar energy installed in our area, so this recognition from Exame is very important. We also have another highlight having to do with the community with the projects of the CPFL Institute.

Now, let's go to slide number four, in which we'll give you more details about the tariff revision of CPFL Piratininga RAB BRL3.8 billion. Net regulatory asset base BRL2.487 million, Parcel B, corresponding to BRL91 million and the regulatory EBITDA, BRL460 million. On the chart, you can see on the lower part of our slide, a growth vis-a-vis the fourth cycle of tariff review, growing by 34%, BRL117 million in growth vis-a-vis a regulatory EBITDA of the fourth quarter BRL460 million in the comparison with the fourth cycle restated or updated, considering the effect of the write-offs and depreciations and the monetary restatements. We see an even higher growth, 47% growth vis-a-vis the basis for the fourth cycle of course with a better expectation of regulatory EBITDA and an expectation of growth in our results for the next few years. And getting into more details as I said before, the positive effect of the growth of Parcel B, 6.17%, the main effect here is an increase in our investments made in BRR. We see that we have an incremental growth of BRL69 million and also an increase in the average rate of depreciation. In the reduction of the Parcel A,

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the main highlight is the end of loans of CCEE, a reduction of BRL300 million practically in our Parcel A, which brings about a major reduction in our tariff for us and customers.

Now, let's go to slide number five, in which we see our sales performance. As I said, it's a challenging quarter, with no clear signs of a recovery in consumption in our concession areas. Here we see a reduction of load in our concession area, 0.3% and sales in the concession area, 1.8% drop and when you have this difference between these two ratios, it is because you have a recovery in the market at the end of the quarter that still does not affect our sales, but it does affect our load. What we have been seeing now going to the fourth quarter, mainly in October, we see a recovery in consumption already mainly because of the temperature effect. We already get a little bit of this effect at the end of the third quarter, and it has an impact on sales that we will be seeing in the fourth quarter of '19.

When we look at the consumption classes, industrial is the highlight with a drop of 4% and what we did here on this table on the right side is to break down this drop in order to see from where it comes and we see that there is a calendar effect, that is not the real effect of market and migration of some clients but they are connected directly to the base grid. So there is no direct relationship with the consumption of energy and also to deal with 0.1% and if you isolate all the effects, you see the macroeconomic effect, that is to say, the performance of the industrial classes with a drop of 2.4% lower than the 4%, but still a very negative effect. Investor consumption once again, talking about a more recent consumption expectation, we see some signs already very timid signs of recovery in consumption in the fourth quarter with a little bit better than the third, but still a performance along the same lines of 2018.

On slide number six, delinquency and energy losses. Regarding delinquency, we see an improvement in delinquency comparing to the second quarter of 2019. Basically the trend that we identified here over this year 2019 after an important increase at the end of last year, so we see that in the third quarter of 2019, our ADA was BRL68 million, going down to BRL64 million and going down now to BRL61 million. This is a positive trend in delinquency, but still much higher than the third quarter of '18, and with a very intensive action of decrease in delinquency on the lower left part. You see our collection actions with a growth of 10.8% in the volume of cuts happened is 89,000 cuts. On an annual base, we intend to have 2.2 million in cuts in our concession area of disconnections. In terms of losses, we closed the quarter with 9.31%, slightly higher than in June '19. And here, we also see a calendar effect in terms of billings and this affects our calculation of losses the way this is done. And our expectation is of a real growth of losses and this is a calendar adjustment, that should be offset in the fourth quarter of '19.

Slide number seven, we see our hydrological scenario with an important drop in the level of reservoirs. In our national interconnected system with an expectation for November to close at 21.4%, one of the lowest levels in our historical series and this also brings about a bigger reliance during the period that starts now with an expectation of recomposition of these levels in the next few months. It should continue to affect our PLD or spot price because it has been consistently superior to the 2018 levels and this is an expectation that it continues to be under pressure over the next few months.

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Slide number eight now. Renewable generation. We have the three sources in the CPFL Renovaveis, with our performance practically flat performance in biomass, growing by 8 gigawatts hour of energy generation, a drop of 35 gigawatt hour in our SHPPs in the South region and also in Minas and Sao Paulo, but the main effect comes from our wind mills, a drop of 169 gigawatts hour especially in June. To the reduction in generation or wind, and you can see on the chart the drop of 10 percentage points on an annual comparison 3Q '18 and 3Q '19. Here, we also see a certain recovery as of October, but still lower than the levels of the (inaudible).

Now I would like to give the floor to Pan, our CFO, and he will be talking about the results of the Group in the third quarter.

Yuehui Pan {BIO 20609514 <GO>}

Good morning, everyone. Now let's go to slide number nine. The EBITDA in this quarter was BRL1.6 billion, with an increase of 4.5%. In the distribution segment, we had an increase of 17.8%. And the main effects were BRL187 million of market effect, mainly due to the increases in the tariff that we had during the last re-adjustments and by the load in our concession area. We also had a gain of BRL42 million because of the RAB report of CPFL Piratininga. On the other hand, the financial assets of the concession had a drop of BRL78 million due to the lower IPCA this year. And lastly, an increase of BRL23 million in PMSO, highlighting the expenses with asset write-offs and also linked to our CapEx of BRL17 million and also our expenses with pension fund BRL6 million. And in the trading services & others segments, we saw a drop of 24.8% and this happened because of CPFL Brazil that had a lower margin in 2019 due to the lower energy prices.

On the next slide, we have the conventional generation segment, which had an EBITDA 0.5% higher and the main effects were the transfer of inflation to the contract, amounting to BRL32 million, the lower volume of hydro and thermal energy representing BRL17 million and a non-typical effect that happened in 2018, which was a tax benefit amounting to BRL11 million and it -- CPFL Renovaveis had it dropped by 10% due to a lower generation of wind energy, BRL34 million and asset write-off and an increase in the expenses by BRL6 million. And on the other hand, seasonality of contracts generated a gain of BRL45 million due to a higher allocation of energy during this period that I would like to remind you that this should be offset during the next quarter.

On slide 11, we show you the net income performance, which was BRL748 million in this quarter, with an increase of 19.4% vis-a-vis 2018. Besides the BRL17 million variation in the EBITDA, the main factor in the financial result, it was an improvement of BRL147 million which is due to the additional revenue that we have with the funds coming from the IPO and the CPFL cash that reached BRL56 million and a reduction in interest rate and also in the net debt, with a benefit of BRL53 million. The mark-to-market effect BRL32 million depreciation with a variation of BRL30 million and there was an increase in taxes due to the better results, BRL65 million.

On the next slide, we show the results year-to-date, up to September, the EBITDA had an increase of 8.6%, BRL370 million and net income going up by 26.5%, represented BRL396 million. In the EBITDA, I would like to highlight distribution that was favored by the tariff

reviews that occurred in 2018. And in the other segments, we see that the weak performance of wind in the CPFL Renovaveis units was offset by the good results obtained in the other ones. Now going to our net income, this has the positive effect of the EBITDA, we also had an improvement in the financial result of BRL268 million due to the lower indebtedness and the lower cost of debt added to the financial revenue from the IPO funds.

Now let's go to the next slide about the company's indebtedness, in which we show, in the first chart, the evolution of the net-debt/EBITDA indicator. Thus, net debt amounted to BRL16.9 billion and EBITDA in the last 12 months reached BRL6.3 billion. Net-debt/EBITDA ratio was 2.68 times, and this increase is due to a higher participation in CPFL Renovaveis during this last period. And on the lower part of the slide, you can see the evolution of the nominal cost and the real cost of debt. The nominal cost reflect a change in the debt profile as from the end of 2018. And the real cost is also affected by the IPCA, which was 2.89% in the third quarter of '19. And I would like to highlight the fact that 64% of the debt is pegged to the CDI.

On slide number 14, we have our CapEx figures. In this quarter, we made an investment amounting to BRL616 million, with an increase of over 17% on a year-on-year comparison. And per segment, we had in distribution a total invested of BRL515 million for the expansion and improvement in the system and the year-to-date amount was BRL1.4 billion. For generation and transmission, we had BRL45 million for Renovaveis; BRL8 million for transmission and BRL2 million for conventional generation.

For the transmission segment, I would like to highlight the beginning of the Maracanau, Sul I and Sul II project, which were acquired during the 2018 auctions and for the services segment, BRL10 million were invested.

Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. It will be in Portuguese with interpreting into English. (Operation Instructions) Our first question comes from Thiago Silva with Santander.

Q - Thiago Silva {BIO 17655676 <GO>}

Good morning, everyone and thank you for the opportunity. I have two questions. First, you mentioned during the beginning of the presentation, a resumption in consumption volume in October. Given the temperature effect, could you give us more color in terms of how much is coming in your consumption area? How much is coming from volume? I mean, if this is a shy resumption or do you think it will come with more momentum? And considering the industrial segment as well? My second question has to do with growth. We know that we have the CEEE distribution company to be sold and other distribution companies in the market. Are you considering those and also, I would like to know about

transmission auctions, the next auction that will be held in December. Are you considering any lots that would make sense to you? Thank you very much.

A - Gustavo Estrella {BIO 18109709 <GO>}

Thank you, Thiago. Okay. Regarding your first question, resumption of volume and consumption, indeed we saw in October and in November, signs of consumption recovery. Basically in the residential segment, because of the temperature, in October, average temperature was above the historical series. And so that drove consumption in the residential and commercial segments. Sorry for the interruption. In the industrial segment, we saw that in the third quarter, we have a 2.4% reduction in consumption. This is macroeconomics and what we see is that from October onwards, there is a certain resumption in remaining flat compared to 2018. So there is some improvement in the third quarter.

So, there is a certain resumption of growth. Our expectation for the year is that we should end consumption on average 1.5% above the level of 2018, and a lot more concentrated on low voltage segment than on the industry. So this would be kind of the breakdown. I think the temperature has an important effect. We don't see a lot of signs of resumption of consumption by the industrial segment.

Your second question has to do with growth. I guess that we have some good opportunities here. Keeping in mind the short to mid-term, that's in the foreseeable future. We have the transmission auction in following our strategy. We want to operate in niches. So there are some lots that fit our strategy. So we have an expectation of yes, bidding in this auction in December for some lots that fit our strategies.

Looking more to the mid to long-term, as you mentioned, there are some important expectations of assets in the distribution area. And again, it has to fit our strategy by region, by location. So I think it makes sense to look at these assets that are possibly put in the market. You mentioned CEEE and some others, and we will be looking into those for sure at the right time. But given our size and the relevance of CPFL in the market, we are definitely a consolidation player in the distribution segment. And regarding generation, with the completion of CPFL Renovaveis' shares acquisition, we are now an investment player in new generation projects. Again, we are keeping this market in our radar.

Q - Thiago Silva {BIO 17655676 <GO>}

Excellent. Thank you. And just going back to my second question, there was an acquisition of Semptra assets in Chile, did you get involved in that acquisition in terms of digital health and could you speak about that?

A - Gustavo Estrella {BIO 18109709 <GO>}

No, we didn't play a part there. Our strategy is very much geared to the Brazilian market, where we have a great competitive edge given our footprint in the market. And like I said, given that we have a number of new potential assets that we could invest in, so our

expectation is that we will keep our focus on the Brazilian market. Other players have an approach of going more international, but they do it, not us.

Q - Thiago Silva {BIO 17655676 <GO>}

Excellent. Thank you.

Operator

Our next question comes from Gustavo Miele with Itau BBA.

Q - Gustavo Miele {BIO 21077665 <GO>}

Good morning, Estrella and Pan. Thank you for the presentation. I'd like to ask a question about CPFL Renovaveis. Perhaps it is the subsidiary that drew our attention the most in the results. But in a broader view, I would like to have you discuss the triggers for results of CPFL Renovaveis for the next two quarters? Anything regarding a lower cost, so we could expect because of the integration to CPFL Energia? After the follow on, anything we could expect in terms of a faster start-up of projects that are being built?

And there is another question, more regulatory in nature. Have you conducted any study regarding the impact of implementation of hour prices in your renewable sources? Because we have talked with some of wind players and they have different views regarding this point. Some expect to benefit from the implementation of this factor, others expect a more negative impact depending on the profile of wind, that they have in their portfolio. Have you conducted any studies about that? Could you give us any number related to that. These are my questions. Thank you.

A - Fernando Mano da Silva {BIO 20542796 <GO>}

Gustavo, thank you for the question. This is Fernando speaking about CPFL Renovaveis. To try to address your first question in terms of results, as you mentioned, we are at the moment integrating CPFL Renovaveis and CPFL Energia processes. We are adopting the best practices. As we mentioned, we have an expectation of capturing synergies in PMSO as well as tax gains, considering an accumulated loss of about BRL2.5 million of CPFL Renovaveis. There is also an expectation of reducing our cost of debt at CPFL Renovaveis. And that we can observe and we can actually see some of this impact in the recent months.

Regarding the results, so it is important to say that wind has been below expected along the year of 2019. But as you know, wind projection is done for a 20-year horizon, with safety. So when they get older arms that have been in operation for more than 10 years, such as is the case of CRR, we have the generation very close to 100%. So it is normal to have a natural resource-performing a little below expectation in the next year, in the following year, you can have a recovery in the following years.

Speaking about spot price by hour, we are considering this topic at the company. It really depends on where the farm is located. A good deal of our farms are located in Rio Grande do Norte in CRR states. Over there, winds tend to be stronger during the day.

During the afternoon, it tends to be very windy in these regions. And that tends to generate a positive effect in terms of the spot price per hour. Other regions of Brazil have a different wind performance, but our funds allocated particularly in locations where it tends to be more windy during the day.

Q - Gustavo Miele {BIO 21077665 <GO>}

Perfect, Fernando. Thank you very much for the explanation. It's very clear.

Operator

(Operator Instructions) Our next question comes from Luiz Vetraz [ph] with Safra.

Q - Unidentified Participant

Hello, good morning. I have two questions. Number one, in the distribution segment, particularly regarding regulatory EBITDA of the companies, I would like to know, how are the companies performing regarding the regulatory EBITDA, in particular at CPFL Piratininga, this increase expected as of the first cycle will be captured in the coming months? And my second question is regarding the discoms. Do they have any losses regarding over contracting and what are the measures taken regarding the migration of customers regarding energy contracting in the long term?

A - Luis Henrique Ferreira Pinto {BIO 19709527 <GO>}

Okay. This is Luis Henrique from Distribution. Regarding regulatory EBITDA, it is in keeping with the real one given the regulatory threshold, there are no great distortions here. It is very much in line. And regarding Piratininga we'd start to see the signs in the next month and in the coming years. So this effect will start being -- will start to be seen gradually in the next months; October, November, and subsequently.

Regarding over-contracting, we don't have any problems. All of those customers that migrated to the free market, this is considered as voluntary, we are following it. So we are using all of the mechanisms for exchange for sale. In other words, we are managing over-contracting really well. This has not been an issue for us. And we've been managing it very well over the years. Regarding possible discussions about the past, well, we are discussing this with ANEEL according to the regulatory rules and according to what is established in the regulations. So it's all under control.

A - Gustavo Estrella {BIO 18109709 <GO>}

Let me just to add to this. Regarding over-contracting, yes, in some companies. One example is Piratininga. We have a relevant surplus but here, basically given a quoted allocation and the migration of customers to the free market, which is actually involuntary. This is not a thing that worries us, all of the surplus that we have is an involuntary surplus that has no impact whatsoever on our results.

Q - Unidentified Participant

Well, excellent, thank you. When you talk about the regulatory EBITDA, you think it is performing? Do you think it's over-performing or is it compatible with the regulatory EBITDA of the other companies Paulista, RGE?

A - Gustavo Estrella {BIO 18109709 <GO>}

We are performing and keeping with the regulatory EBITDA, but just a little bit.

Q - Unidentified Participant

And regarding the regulatory WACC in Q3, was it penalized in anyway?

A - Gustavo Estrella {BIO 18109709 <GO>}

No. When we defined a WACC of 809 [ph] it would valid until the end of this year of 2019. So all tariff reviews of our Group that happened in 2018 or Piratininga now in 2019, will remain with a WACC of 809 and this will continue until the end of the cycle, so four years of Piratininga and five years in the case of all of the other companies, Paulista and RGE.

Q - Unidentified Participant

And for the next cycle, have you defined anything? Is this being discussed?

A - Gustavo Estrella {BIO 18109709 <GO>}

There is an open public hearing that will be held today and this topic will be discussed, so we are following this up close, but there is no definition regarding the new WACC.

Q - Unidentified Participant

Excellent. Thank you very much.

Operator

(Operator Instructions) This concludes the question-and-answer session. I would like to turn the floor back to Mr. Gustavo Estrella to proceed with his closing statements. Please go ahead, sir.

A - Gustavo Estrella {BIO 18109709 <GO>}

Very well. Again, I would like to thank all of you for joining us in this earnings conference call and for your questions. I just want to stress some important points about our company. We completed the process of acquisition of CPFL Renovaveis' shares. And as we said, in the share issuance process of the company in June, this is a consolidation process in the CPFL Group of building some important benefits to the Group. Some of them are already being built, we are finalizing the integration process of those teams; CPFL Renovaveis and Energia. So we are going to have a cost benefit particularly as of 2020. We have an important expectation of reducing our funding cost that we have a program of debt exchange at Renovaveis, with an expectation of reducing the cost of our debt and also in the integration and merger process between CPFL Geracao and Renovaveis. The benefits will be captured along 2020. So this is a process when have

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been kicked off the expectation is that the process will be ended by the end of 2020 and the expectation is that it will bring good results for the Group. For 2020, we expect the economy to roll in, the reforms are being now taking place, the pension reform was approved, we see even if it is in its infancy, signs of consumption resumption for the industry and the expectation for next year, is that we're going to have the economy rebounding more strongly. And this will have a reflex on power consumption and a good effect on our commercial losses and delinquency rates.

In terms of opportunities, I think of the Group is looking at new investments. We are going to have the December transmission auction and we will take part, we are monitoring and we are paying attention to opportunities in the renewable generation segment, particularly now with the integration of CPFL Renovaveis and also in distribution. Now, if there is an interesting asset in the market, we'll look into it. So these -- this is the outlook for 2019 and we have a more positive expectation regarding 2020.

Again, I would like to thank all of you for your participation and have a good day.

Operator

That concludes CPFL Energia conference call for today. Thank you all very much for your participation and have a good day.

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