Q3 2016 Earnings Call

Company Participants

- Andre Dorf, CEO
- Gustav Estrella, CFO, VP

Presentation

Operator

(interpreted) Instructions for you to participate will be given. (Operator Instructions) I would like to remind you that this call is being recorded. Before proceeding we would like to clarify that forward-looking statements that might be made 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 also information currently available to the Company. Forward-looking statements are not guarantees of performance, they involve risks, uncertainties and assumptions as they relate to future events. And therefore depend on circumstances that may or may not occur. Investors should understand that (general) economic condition industry conditions and other operating factors can also affect the future results of CPFL Energia and could lead to results that differ materially from those expressed in such forward-looking statements.

Now we would like to turn the conference over to Mr. Andre Dorf. Mr. Dorf, you may proceed.

Andre Dorf {BIO 15460232 <GO>}

Thank you. Good morning and welcome to another CPFL Energia earnings conference call, now talking about the Third Quarter of the year.

As usually we have a short presentation and afterwards we will available to you to answer questions you might have.

Starting on page number 3, we give you some highlights for the quarter. We saw a reduction in the loan measured in our concession area by 2.3% and we will be going into details about that a little bit later and we will be mentioning the segments that dropped.

The contracted demand was preserved and the free market clients 0.6% of peak. And 1.3% peak, a reduction of 5.6% in net revenues. And at the same time we posted an increase of 2% in our EBITDA. Besides (during this period) we had a tariff adjustment of (inaudible) in October with an average effect of minus 24% as perceived by consumers. And the (b parcel) that impacts our results was adjusted by 9.6% at the same time.

The SJ balance was very positive as well. We went from a (secure) financial asset of BRL170 million to secure financial liability of BRL388 million, more cash effect investment in the period of BRL649 million; split into distribution and renewable generation mostly, our net debt amounted to BRL11.4 billion at the end of the period and a leverage of 3.07 times. So we continue decreasing our leverage reaching almost 3 times, which is an adequate level for the great pace of the Company.

During this period there was a commercial startup of many turbines in the (inaudible) to windfarms 174 megawatts installed; in total, 230 will be installed by the end of the year. We also saw the beginning of CPFL's management over (RGE Sur), a transaction that was announced about four months ago. So we have the closing of this deal. And our team took over management of RGE Sur and we are extremely pleased and very well impressed with the quality of the team and also with integration of the operations. And no hiccups on the way in all areas.

Also during this period we had the announcements of the decision of BV and (inaudible) announcing the sale of their (state to state good). And, Camargo had already talked or mentioned their desire to sell their stake. And their suffering was extended to the other controlling shareholders. So they decided to agree into a deal and from the (inaudible) viewpoint we have the provisional measure number 735 dealing with many different points in different segments of the power sector.

So there is an array of measures that was approved by the lower and upper houses, is subject to the presidential approval. And will bring opportunities to the agents in the sector.

On page 4, we have a macro view of our cash generation measured by the Company's EBITDA in Q3. We had a total EBITDA of BRL985 million in the period. Contributed -- where distribution accounted for almost 40%, conventional generation 35% of participation in CPFL (inaudible) 18% and commercialization and services 8%.

If we analyze segment by segment, starting on the upper part on the upper right, we see a drop of cash generation very much because of the drop in the load in our concession areas and also an increase in collections. And also losses in the period. I would like to remind you that we also had an increase in the allowance for doubtful accounts. Vis-a-vis our average, our historical average. But this is totally offset by increases in our financial results and the lines of fines and interest, in conventional generation, no extraordinary items here.

You can see an increase of 4.7% in the quarter on quarter which is because of price adjustments in our contract and renewable generation; likewise we saw the price adjustments and better conditions regarding wind and also the startup of some projects on the left, trading and services.

Although the amount is lower than the (other), the variation is important. And we had a one-off year which was an indemnification that accounts for about half of this variation. It has to do with the contract. And on page number 5, we talk about distribution.

As I said before, over the highlights we saw a decrease in the load in our concession area as you can see on the upper right of the slide, a 2.3% decrease, a more substantial decrease in the captive market, the free market accounting for an increase whereas the captive market has a reduction of about 4% partially explained by the migration of clients.

On the lower part of the slide, we saw a drop in sales. And I would like to tell you that there is a gap here between our billing and the load measured. And again the captive market representing the total drop that we had in the concession area.

In the middle you can see sales by consumption segments. So the totals are the same; however here we show you the breakdown per class of consumption. We can see here that the industrial segment was the one that had the highest impact for the negative variation in the period. And I would like to add a remark here.

In one of our (discos) we had one specific client of the steel sector that reduced consumption extensively during this period. So if we were to exclude this client specifically, the drop instead of 4.9 would have been 1.4.

On the upper left we see the deceleration at the growth of new connections and this is an indicator that we always measure. So we had almost 3% in the Third Quarter of 2015, whereas now we had less than 2% in this quarter as a consequence of the macroeconomic additions.

In terms of losses, we had 8.32 losses in the Third Quarter of 2015. And we saw an increase in the Second Quarter going up to 9%. And we continue at this level slightly below 9% in the Third Quarter of 2016. This is partially explained by the change in the market mix, as the industrial clients are reducing their consumption. And because of that we see a bigger weight of low voltage here and also a higher number of disconnections that generate higher losses in the period.

On the next slide, we talk about delinquency in the distribution sector, we start on the upper left. With the evolution of our ADEA, our allowance for doubtful accounts. And although we see a slight relief in the quarter, we still consider that it's a little bit too early to say that this needs a recovery.

We still have the macroeconomic situations and employment situation, income situation with a major impact on our consumers, our customers. So in spite of this small relief, we do not believe this is a sustainable recovery sign.

On the right, we see our collection actions. And the main one is the disconnection in the Third Quarter of 2016. We had 340,000 disconnections in the quarter. Relatively stable vis-a-vis the previous quarters. But much higher than what we had a few quarters back.

On the lower part of the slide, we show you the total past-due bills as a percentage of revenues. And I will concentrate on the left part. So we saw an increase of about 0.80%

on average, to 1% average. But apparently more stable. So in this case we can already see a certain stability in the last few months.

Let's turn to page number 7 where we turn our attention to generation. The highlights for the period are the fact that again we have an unfavorable hydrological situation. And now concentrated in the North and the Northeast regions. And if we look on the lower right, this is what draws our attention, which is the level of our reservoirs at the Northeast as a % of just the maximum capacity. And this is where we see 10% in the Northeast.

We also had the start-up of our 174 megawatts to November from two windfarms that should be bringing about 231 megawatts installed by December. GSS had a much lower impact. North material for the quarter BRL4 million vis-a-vis BRL53 million, in the Third Quarter of 2015. And our remaining exposure to GSF was only 12% of the Company's hydro capacity.

Of our (restart) capacity on the right you can see 63% of large power plants had a power plants followed by wind, 18%. And then biomass, SAPs and TPPs with about 6% each one of them.

Now I would like to turn the floor over to Gustav Estrella so that he may talk about the results, he is the CFO of our group.

Gustav Estrella

On page eight we have our results already reported. And in the format that we always publish in the IFRS and managerial as well. We make some adjustments, especially the consolidation of our generation companies and also the exchange rate variation, vis-a-vis some nonrecurring effects.

As you can see on the lower part of the slide, the adjustments of the Third Quarter of 2016 are basically consolidation, proportional consolidation. And the (inaudible) currency variation in 2015 in the Third Quarter we had the adjustment in the GSF as well, where -- and we exclude this now in order to be able to compare the two results.

So if you look at the managerial results you can see it drop in the net revenue of 5.6% of BRL253 million and basically what explained this reduction in revenues is the effect of the reduction of the regulatory assets. And as we saw, it became a liability and has an impact on net revenues. And as respective for the net revenue, the impact of tariff reductions, future tariff reductions, should continue to make the revenues of the Company (dark) in the next few quarters. This does not affect the EBITDA because we saw that the effect have to do with parcel A items. And we see a growth of 2% in EBITDA or BRL20 million of the comparison with 2015. And also here it is important to mention the effect on the net income with a drop of 24.8% or BRL77 million. And this is concentrated on two effects.

The first is the adjustment of the financial asset of the (Peter Tuninga) concession and the adjustments was carried out in the First Quarter of 2015 when the Company had a tariff view. So we had to make this adjustment according to the regulators' rules. And at the time it had a positive effect of BRL70 million (inaudible) results.

And of course this is a one-off nonrecurring effect and it affects 2015, however it does not affect 2016. And (inaudible) that happens in 2016 is merely accounting.

The impact of the marked to market of our debt of (4131), that dollar denominated debt. And so we only marked to market in this quarter in a comparison and with 2015 this is a negative variation of BRL77 million.

Once again it's just a book effect because in the year to date of nine months, the effect of the marked to market up to September is BRL1 million. Again this is an effect that is offset over the next few quarters.

Let's talk about slide number 9 here. With the mean variations in our results, when we look at the variation of the EBITDA, the variation of BRL20 million, most of that comes from the commercialization business and the service business with the projected variation of BRL43 million. And the biggest variation here is revenue from indemnity from context. And (inaudible) energy in this context, there was a delay in the start-up, as basically in the transmission lines and for the commercialization company this has a positive effect of BRL22 million and indemnity. And another important highlight is the fact that part of our strategic long-term plan is to strengthen our business and services. And we see already an increase in the results of CPFL services of BRL10 million, basically maintenance transmission and distribution businesses with BRL10 million. And also an increase in results coming from our IT company with the positive results of BRL5 million.

In conventional generation, this is basically the transfer of the inflation items of our contract. So we saw the same positive impact on the adjustment of parcel B (and Tanega) to also happens in the same proportion in a generation contract, that is to say the transfer of the inflation items. And this is what explains the increase and results of generation of 2016 vis-a-vis 2015 in (inaudible).

There is an important effect of the coming onstream of new projects, mainly the wind and that brings positive effect of increase in our results and also the (matter verga SVP) with a positive EBITDA for the group and in comparison with 2015 we had 2015 as a very negative year vis-a-vis wind. And we see an improvement here in 2016 regarding this year. And therefore we see an increase of almost 18% of results only from wind energy.

For distribution, a negative effect of BRL54 million. And basically. And Andre has already talked about it, it has to do with the performance of our load in the concession area and the impact that we have in the market is basically based on the drop of commercial consumption mainly and also residential consumption.

I would like to remind you that the effect of this drop in industrial consumption does not affect our result there, because of the demand contracts that were not reduced. So the effect that you have is based on the low voltage market performance. And we have already shown an increase in expenses because of collection actions. And especially our disconnections.

Once again, we showed an increase in the number of disconnections or cuts vis-a-vis the previous quarters, which brings about additional cost to the Company in this quarter of about BRL15 million. And another effect, BRL32 million has to do basically with the refund of extraordinary gains of parcel A. And we talked about this impact in the First Quarter of 2016 where we had a positive effect on our results in this quarter.

And because of the calendar of our (reading) and the way we post and account for revenues, we already had an expectation of refund of part of these extraordinary gains over these months. And this is what is going on right now. And year to date it is neutered because of this effect.

And there is another effect which is the increase in losses in the comparison quarter on quarter from 8.3 to 8.9. And this also has an impact for this quarter.

And when we talk about the effect of our net income, these are one-off, they are nonrecurrent. And because of that, we are delivering lower net income. But this is not recurrent.

Slide number 10. Once again, we consolidate our leverage position close to 3 times. We had already reported 3.10 leverage and now 3.07. And of course the expectation of levered reduction that we presented in the Second Quarter was what guided the Company in terms of acquiring RGE Sur where we had the necessary room in our balance sheet to make this acquisition. So not considering yet the effect of the consolidation of the new asset. But this leverage as you can see is below 3.10.

Our debt profile is maintained practically stable between CDI and long-term interest rate in prefix debt. You can see that we have a lot in CDI. And regarding the cost of our debt, the outlook is very much related to the attempts to reduce the CDI over the next few months. But in the short run what we see is an evolution of the nominal cost of our debt because of that increases that we saw in the last few quarters in the CDI rate.

On slide 11, we saw our debt amortization schedule. Once again, it varies from cash position. And we keep repeating this. This is a top priority on the part of the Company to preserve our liquidity as a group. So we have a cash balance of BRL5.2 billion totally funded and all maturities up to 2017. And of course our challenge here has to do with the (debt) for 2018 which is already known by you. We look at the market and alternatives of financial instruments or refinancing of the debt for 2015 with some debentures, incentivized debentures and so that we may once again refinance this -- these maturities for 2018 and 2019 as well.

On slide 12, let's talk about growth. On our project in (inaudible) so we already have the project for the windfarms compensated (inaudible) already, up to the end of this year we will have 100% of the wind farm already in commercial start-ups and (inaudible) the windfarms over 2018 and (inaudible) (HBP) for 2020. All of them are being discussed with the B&DA (inaudible) that have already approved the financing and (inaudible) they are being analyzed.

On page 13, I believe that the highlight is the start-up of our JE South or Sur at the beginning of this month as Andre said. The most important point here is very positive because we have a very good impression of the beginning of the operation, be it because of the headcount. And a lot of collaboration, people who know the Company in debt and also very strong in terms of processes and systems to the process of integration starts with the assets of CPFL Energia with the very positive outlook regarding this integration.

And I believe we should also highlight our process for restructuring of (inaudible) it was a very -- it was a very expensive one, very expensive debt and we have already renegotiated 100% of this debt to 114.5% cost of the CDI still with a term of four years. And now with a different profile and much more adequate for the specific assets.

So our expectation is that during this process of integration that it will come to close by the end of the year and our outlook for that is very positive. Regarding the integration of these new assets.

On our slide 14, we talk about the state's great transaction. The transaction is developing according to our expectations. So the proposal was -- (inaudible) was in September. And the approval by Hitachi haven't already in September so the expectation is the approval by NL so that we may go ahead with the closing of this transaction over the next few months.

And lastly, the performance of our shares. Of course, the performance of our shares had a very strict correlation with offering by state grid. So 17.9% in the Third Quarter reflecting this new outlook. It's a proposal submitted by state group and also the increase in the volume traded (inaudible) 39.2 BRL59.4 billion and also with a similar performance in the New York Stock Exchange. So the presentation has come to an end. So now we will open for questions from the audience.

Questions And Answers

Operator

Ladies and gentlemen, we will start the question-and-answer session now (Operator Instructions)

We now conclude the Q&A session. And I would like to take the floor back to Mr. Andre Dorf for his final remarks.

A - Andre Dorf {BIO 15460232 <GO>}

So we are now at the end of 2016, this has been a very intense year. We have experienced many changes in the political environment of the country, in the power market and also in the Company itself. I would also like to mention that in the first three quarters, the division of RGE Sur, the transactions concluded, we are now betting in the new efforts of the Company in terms of commercialization as well, therefore this has been a very good year to all of us at CPFL.

And now I would also highlight that our team is quite motivated and totally engaged with the company strategy. So with no further ado, I would like to thank you very much for participating in this call. And have a good day. Thank you.

Operator

CPFL's audio conference has now concluded. We would like to thank you all for participating and have a good afternoon.