

Q2 2015 Earnings Call

Company Participants

- Luiz Eduardo da Veiga Sebastiani, Chief Financial and Investor Relations Officer
- Luiz Fernando Leone Vianna, Chief Executive Officer & Director
- Sergio Luiz Lamy, Chief Executive Officer, Copel Geração e Transmissão S.A.
- Unverified Participant
- Vlademir Santo Daleffe, Chief Executive Officer, Copel Distribuição S.A.

Other Participants

- Eduardo Cancian, Analyst
- Maria Carolina Carneiro, Analyst
- Vinicius Canheu, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, thank you for waiting. Welcome to Companhia Paranaense de Energia Copel Second Quarter of 2015 Earnings Conference Call. We'd like to inform you that all participants will be in a listen-only mode during the company's presentation. Afterwards, there will be a question-and-answer session and further instructions will be given.

Before proceeding, let me mention that any statements that may be made during this conference call related to Copel's business outlook as well as operating and financial projections and goals are based on beliefs and assumptions of the company's management and on information currently available to the company. Forward-looking statements are no guarantee 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. Investors should understand that general economic conditions, industry conditions and other operating factors may also affect the future results of Copel and cause results to differ materially from those expressed in such forward-looking statements.

Today with us, we have Mr. Luiz Fernando Leone Vianna, CEO of the company; Mr. Luiz Eduardo da Veiga Sebastiani, CFO and IR Officer; Mr. Sergio Luiz Lamy, CEO of Copel Generation and Transmission; Mr. Ricardo Goldani Dosso, CEO of Copel Renováveis; Mr. Reinhold Stephanes, CEO of Copel Participações; and Mr. Vlademir Daleffe, CEO of Copel Distribuição. The presentation will be delivered by Copel's management and can be followed on the company's website at www.copel.com/ir.

Now, I'll turn the conference over to Mr. Luiz Fernando Vianna, CEO of the company.

Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

Good afternoon, everyone. Good afternoon, our management colleagues. Welcome to our conference call to present the earnings of the second quarter of 2015. We started the year with a challenging adverse scenario in the electric sector. And this is partially due to a possible new energy rationing in Brazil, which may bring back, to some extent, and even more severely, the sad experience lived in 2001. To make things worse, the extremely high cost of energy stemming from the continuous dispatch of thermal power plants will no longer be paid by industry loans or by the government, therefore, adding even more pressure to the sector.

The government solution was to implement flags and match tariffs to energy costs by using the so-called tariff realism. On the one hand, this brought us some relief, particularly to distribution companies. However, on the other hand, it also had a dramatic impact on consumers. The remedy was bitter, but necessary to bring stability back to the sector.

In June, we had a second dose of this bitter treatment with the application of Copel's distribution annual tariff adjustment. At that time, we used all the amount authorized by Aneel and we brought to an end the deferrals of the last two years. And in August, we can already see that the tariff increase combined with the weak economic scenario in Brazil has affected energy consumption in our country. Until June, consumption was 1.1% lower year-on-year according to the EPE or the Energy Research Company.

However, despite the adverse scenario, energy consumption in Copel Distribuição's captive market remains positive, growing by 1.3% in the first half of the year vis-à-vis 2014. The reduction in energy consumption does not affect the distributors market alone. It also affects the results of generation companies, particularly hydro power plants, which were already delivering below their capacity due to the low level of reservoirs. Due to the lower demand and maintenance of existing thermal power plants, hydro generation remains at lower levels.

Consequently, GSF is approximately 20% below the 100% at a time in which we expected to see a rebound. But if on the one hand, the decline in demand had a negative impact, it also helped to decrease PLD or spot price, which was reduced to levels close to R\$100 per megawatt per hour. This fact was also affected by hydrology, which was above-average in July. These two factors, lower demand and more favorable hydrology, encouraged our government through the Electric Sector Monitoring Committee or CMSE to shut down the most expensive thermal power plants in early August, therefore, decreasing the cost of energy to the system, which may bring some tariff relief in upcoming months to distribution companies.

At this point, it is important to say that our thermal power plant, Araucária plant was not affected by the measure and continues to run on working days in compliance with the national operator of the system. Please note that the current unit variable cost of the plant approved by Aneel is R\$595.11 per megawatt per hour. And this amount will be in effect

until January 2016. Our expectation is that in the second half of the year, this thermal power plant will be up and running.

Moving now to slide four, I'd like to highlight another point. The fact that recently, more specifically on July 7, the concessions of plants Parigot de Souza and Mourão I expired. As a result, the energy generated by these plants was allocated to distribution companies in the quota system, whereas the operation remains under Copel G&T's control awaiting for the bidding process that will assign the new operator.

Copel Distribuição concession also expired on July 7. The process to set the new rules and conditions to expand the contracts is being analyzed at the Brazilian Federal Accounting Court.

We'll keep on delivering our services until all conditions are set. We are fully convinced that Copel Distribuição's concession will be renewed since we meet all the quality and financial sustainability requirements required by the government.

Before we comment on the earnings of the quarter, let me make a brief overview of the first months of our management. Since the beginning of this year, we have been focusing our efforts on the completion of construction works and the startup of the projects recently acquired.

On slide five, we can see that in the transmission segment, if we consider our stake in SPEs, we have already started 491 kilometers of lines and one substation since the beginning of 2015, adding therefore approximately R\$36 million to our APR. By year end, we expect to start another 1,600 kilometers of lines and another four substations, adding therefore another R\$129 million to our company's APR, which will exceed R\$400 million.

Regarding the Renewable Energy segment, we've recently started another two wind farms that comprised the portfolio of the Brisa Potiguar Complex. Wind farms Ventos de Santo Uriel with 16 megawatts and Asa Branca I I with 27 megawatts of installed capacity. As a result, our commercial operation totals 197 megawatts. Another three farms Asa Branca II, Asa Branca III and Nova Eurus IV are already in the commissioning phase and commercial production is expected to start up in upcoming weeks increasing our wind power to an installed capacity of 278 megawatts.

Now, please note that the four wind farms of São Miguel do Gostoso Complex with 108 megawatts of installed capacity in total, which is a partnership between the Copel and Voltalia are already scheduled to start their commercial operation only awaiting for the completion of the transmission lines and activity under control of other stakeholders.

Now, turn the call over to my colleague Luiz Eduardo da Veiga Sebastiani, our CFO and IRO, who'll give more detail on the earnings of the quarter.

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

FINAL

Thank you, Luiz Fernando Vianna. Good afternoon, everyone. Once again, thank you for joining our conference call. We're now glad to highlight our earnings. As you, ladies and gentlemen, can see on slide number six, Copel's operating revenue increased 32% in the first half of 2015, reaching R\$8.1 billion. The main driver of this growth is the 49% increase in the revenue of electricity sales to final customers reflecting adjustments to the tariff used by Copel Distribuição, 24.86% in June last year and 36.79% in March this year due to the extraordinary tariff review. Please bear in mind that these adjustments were necessary to offset the increase in energy costs as we all know.

In addition, R\$1 billion were recognized in the revenue of sectorial financial assets and liabilities during this period. This amount comprises mainly of tariff deferrals which are now being recovered via tariff after the adjustment on July 24 of the current year, which was very important to the company.

The sectorial assets have not been recognized in the balance sheet since the adoption of IFRS and started being posted again at the end of 2014 after the amendment to the concession contract was signed, ensuring that the residual amount of Parcel A and other financial components not recovered by a tariff will be included in the indemnification calculation should the concession be terminated.

On the next slide, number seven, we give you a breakdown of operating cost and expenses in the first half of 2015, which totaled R\$7.2 billion or 38% higher year-on-year. This is mostly due to the increase of 64% in the cost of electric energy purchase for resale. A significant increase stands from several factors which include new contracts. Please note that Copel Distribuição purchased 302 average megawatts for R\$385 per megawatt per hour in the adjustment auction held in January this year. Other factors include monetary restatement by inflation and higher dispatch of several power plants over this quarter.

This increase also stands from the end of the transfer of funds from CDE and ACR accounts which offset costs of over R\$1 billion in the first half of last year and an increase in Itaipu's tariff which was also affected by the depreciation of the U.S. dollar.

In addition to energy costs, there was a 58% increase in cost of charges of the grid used, particularly reflecting higher System Service Charges or ESS related to the non-cost merit based dispatch of thermal power plants.

Manageable costs increased by 12% in the first half of this year compared to the same period of the previous year due to higher expenses with personnel and third-party services and the collective bargaining agreement in addition to inflation and higher cost required to offset the company's growth in the period within the same policy standards.

Slide number eight shows that the consolidated EBITDA remains stable vis-à-vis the same period of last year totaling R\$1.3 billion, a margin of 16% over the operating revenue.

Copel GeT's cash generation accounted for 57% of the consolidated EBITDA. Copel Distribuição accounted for 18% and Copel Telecom 5%. The other companies of the

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group accounted for 20%. The main contribution came from Araucária Thermal Power Plant.

As to the EBITDA margin of Copel GeT, Copel GeT closed the first half of the year with a margin of 49%, distribution accounted for 5% and telecom 44%.

On slide nine, we show Copel's consolidated net income which totaled R\$772 million in the first half of 2015 or 7% below the same period of 2014. Despite the drop in the first half of the year, there was 22% growth in the second quarter year-on-year. If we analyze the earnings of subsidiaries, we can see that Copel Distribuição's net income amounted to R\$171 million in the first half of the year, recovering very importantly the loss posted in the same period of the previous year.

Copel GeT's net income totaled R\$532 million at the end of the period or 35% lower than the previous year affected by the higher GSF and the reduction of PLD or spot price cap. Copel Telecom's net income in turn reached R\$29 million, a 5% increase vis-à-vis the first quarter of 2014, reflecting the market's growth in the period.

Lastly, I'd like to highlight that Araucária Thermal Power Plant contributed to the result of the first half of this year, as we can see on slide 10. Net income amounted to R\$255 million and EBITDA totaled R\$386 million. This is mostly due to the fact that the Thermal Power Plant operated nearly non-stop in the first half of 2015, delivering a total of 1,827 gigawatts.

The first half of 2015, Araucária Thermal Power Plant delivered a total of 1,827 gigawatts per hour. Please bear in mind that the plant operated with a unit variable cost of R\$765 per megawatt per hour between February 1 and May 30, when it recovered all administrative and operating costs expected for the full year, in addition to the amount required to pay the assets according to Aneel's resolution to plants such as Araucária under the merchant modality.

Since June 1, the plant's unit variable cost was reduced to R\$595 per megawatt per hour. This price reflects gas costs only and will remain effective until January 31, 2016.

These were our highlights. And now, we'll be happy to take your questions, ladies and gentlemen. Our CEO, Luiz Fernando Vianna and all the officers of the company Copel Distribuição, GeT, all subsidiaries, all officers are here to take your questions. Thank you very much.

Q&A

Operator

Ladies and gentlemen, we're starting now the question-and-answer session for investors and analysts only. The first question is from Eduardo from Votorantim Bank.

FINAL

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Q - Eduardo Cancian {BIO 18264143 <GO>}

Good afternoon, everyone. Thank you for taking my question. I have two questions. My first question has to do with the energy value (20:00) that is not contracted for 2016 and 2017. What is the company's plan, vis-à-vis alternative say you want this (20:12) energy? And what about the approximate price you envisage for energy in the free market?

My second question regards the negotiation and GSF. We have almost daily data, so could you give us an update of the assumptions that are prevailing today? Thank you. These are my two questions.

A - Sergio Luiz Lamy

Eduardo, I'll answer your first question. And then I'll kindly ask you to repeat your second question, because we had a problem in our sound system and we could not fully understand your second question.

Just to highlight that, Eduardo, regarding the volume of non-contracted energy and with regard to our sales policy and the expected price for the future, to some extent, we believe that there are very significant facts that will happen as of next week. Once we have the first step by the government, we introduce a proposal in an attempt to solve a problem of the low GSF in generation plant.

So we understand that this bag will be so important that it will have a significant impact of all projections. So we would rather stay more reliable forecast once we have more information as of next week. Once we have the publication of the rules to be set by the government to solve the GSF problem.

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

Can I just add something? We expect to see two provisional measures next week, which will support what Lamy said and they go as follows. First, it is a provisional measure that introduces a solution that has been drafted in the sector for GSF. That provisional measure is expected to be published by Monday or Tuesday. The other provisional measure, which also has a strong impact not only on Copel, but certainly against FERC are new rules to concession. And they also include concessions that already expired, which expired in June or July, which is the case of Parigot Souza and Mourão plants. So we cannot make any forecast about our strategy and not only forecast about price, because there will be a heavy impact on energy prices as of next year.

Could you ask your second question again, Eduardo?

Q - Eduardo Cancian {BIO 18264143 <GO>}

My second question was along the same lines of what you said before, about a topic that has been negotiated for the GSF. Based on conversations with stakeholders and agencies, the overall lines of the process are changing constantly. So we would like to hear more from you about the overview or the general lines of this agreement that is being drafted. Do you expect to see a different solution for the captive market and

another one for the free market? Do you expect to see a reduction of price in the captive market?

So these topics were already brought to negotiation, so I would only like to clarify if they will prevail or if there has been any change.

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

What we expect to see is a very general overview. Regulation by decree law will only be an addition. So regulations will be in effect as of January and this asset will be used even by companies if necessary.

And the latest news address a different approach to the captive and to the free market. We don't know if this will be published in the provisional measure or in the subsequent and we don't know what the amount of the discount would be like. Now, this is still very open, as to the past due or expired concessions, our expectation is that the rules created in the past by Measure 579 would amend it. So we have part of the value of the energy converted into produce, but not the other part and naturally it will involve the bidding process. There will be a tender, but conditions will be greatly improved.

A - Sergio Luiz Lamy

Eduardo, may I just add some comments? My comments are related to the topics mentioned by CEO, Vianna. There is no doubt we expect to see different solutions to the regulated market and to the free contract market. The expectation for the regulated market is that there'll be a risk premium charged by generation companies to the benefit of distribution companies and for each one of ACR contracts, there would be a conversion from hydraulics generation to be available.

So the risk premium amount is still being speculated and we haven't come to a more final amount in terms of what the government may do. As to the free contract environment, we expect to see a different solution. In other words, mitigation of risks of ACR through the purchase of Reserve Energy to be settled in the spot market and expense the (28:08) generators might generate a regulatory asset, which in turn might be offset in the future maybe by an extension of concessions.

For us, generation companies in our associations in which we're members, particularly at Apine and Abradee, a very hot topic that appears quite often and possibly the government is sensitive to is the so-called purification or cleansing of GSF. We would eliminate GSF calculation and the Reserve Energy out of merit and may be even important energy for contract purposes.

Just adding to the previous comments, they are considering - there is a concern about purification and the Reserve Energy, but for imports and generation out of merit, this is running smoothly, but as to the Reserve Energy, there is strong resistance by the government, but the request continues.

Q - Eduardo Cancian {BIO 18264143 <GO>}

Okay. Thank you.

Operator

The next question is from Carolina Carneiro from Santander. Please go ahead.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Good afternoon, everyone. I have two questions. My first question; is there any update about the federal audit court vis-à-vis the concession renewal of distribution companies? And if we consider the proposal by the regulating authority, we believe Copel would have to be adapted or to adapt itself to meet the leverage target, vis-à-vis the company's EBITDA at least in a long term metrics. So, I would like to know if the company has any plan or how does it intend to fit into these roles to be complaint to the roles?

And the second question is about the investment guidance. If you consider what you did year-to-date and considering our target or your target for the end of the year, we feel that maybe the company's investment curve is not as fast as before. So, if we analyze your investments right now, we would not reach the target. So, from the previous target that you mentioned in the beginning of the year for investment purposes, what would really happen and what might be delayed for next year? These are my questions. Thank you.

A - Vlademir Santo Daleffe

Carolina, Vladamir Daleffe speaking from Copel Distribuição. Let me answer your first question about the TCU or Federal Accounting Court. We're optimistic. They wanted to affect the renewal process, but we are optimistic because we understand that this is very consistent with the defense of the ministry. And you also wanted to know still about the concession; you wanted to know the concern about the indicators proposed by Aneel and being discussed. We are still talking to Aneel or the government about these metrics. One of them is related to quality and others are related to financial performance.

As to financial, your financial management concern, we are being more conservative, because in the first three years of a five-year cycle, we are nearly meeting all the targets and expectations by the government, maybe we had a non-recurring problem in the fifth year, but up to then, we can work a lot with efficiency gains and lowering costs.

As to quality, we are concerned with a stringent contract which sets a target, but gives us no margin for 2015 and we assume it will be too high risk. If you have any serious problem that might interfere with the performance, we might put the concession at risk. But we are having close conversations with Aneel, the government, and we are aware of the stringent nature and we expect them to revisit this.

Answering your second question about transmission, we expect maybe investment will be lower than our initial plan. Our expectation is to be around R\$700 million by year-end. But one reason is that we had another assessment of investments considering the signs given

by the government of importance to lower quality improvement index, particularly by the end of the fifth year for ELC and EFC. So, we want to improve results, particularly in rural areas in which quality levels are below the expectations.

As a result, we are working on an investment plan about R\$500 million for future years more oriented to the rural segment not only to improve quality, but to adapt to the efforts of the mines and energy ministry and quality requirements to maintain the concession.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Thank you very much.

Operator

The next question is from Vinicius from CS. Please go ahead, sir.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Good afternoon. I would like to know Copel's strategy for the next transmission auctions. Is there any project you're interested in developing or do you plan to be out of these auctions for a while? Thank you.

A - Operator

There'll be an auction on the 26th and we are still considering the possibility of participating in the auction of the third circuit of Teles Pires line but we haven't come to any decision yet. We are still considering whether we'll be there and who we should do it with. We expect to come to a decision by next week. As to the solar energy auction, we decided not to participate in this auction and we'll await for future auctions.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Okay. Thank you.

Operator

The next question is from Julielno from Priel Investment Bankers (36:22). Please go ahead.

Hello, everyone. I still have a question about the GSF package. My question goes as follows.

We assume there might be a reimbursement about everything that was paid by the company vis-à-vis the first half of the year to the support package. We will offset the energy that expired, for instance, you have the three HPPs that expired by mid-year. With brief math (37:03) you paid GSF. And would you have the R\$30 million reimbursed? And to some extent will the R\$30 million - well, would there be a calculation to lower the tariff from 2017 onwards? In other words, the energy that expired in mid-year, will it have any impact on the price from 2017 going forward?

The package starts in January 2015, that's already an agreement, a consensus. Our concession expired on July 7. Parigot and Mourão plants concessions are included in this package, in this MP.

Okay. But the approximate R\$30 million, will this amount be used to lower the tariff in the future or not? We'll be hearing about that discussion in the sense that there would be an extension in the concession. And if this extension happens, I don't know if there might be a specific plan to be taken into account in this extension. But my question is will the extension also factor in the R\$30 million? That's my first question. And second question, the lower tariff to transfer the rest of the generator onwards. So, will this take into account the future or only what was there in January 2015?

A - Sergio Luiz Lamy

Juliéno, (38:51) Sergio Luiz Lamy speaking now. Let's break down your question in two parts. First, about expenses; GSF in 2015. There are different negotiations and approaches to ACR contracts and ACL contracts. More specifically, about ACR contracts, this invokes a lot of theory in almost all discussions that were held with the government and we don't know yet, we still have to wait until the Provisional Measure is published. We don't know what the final version will be. The process is quite dynamic and has been changing very dynamically.

But the last draft considered payment by the generation party of a risk premium. So this would happen if the distribution companies would bare its burden so to speak as of January 2016. And the math or the amount taken by the generator in 2015 would be converted into a regulatory asset and, so to speak, would be returned by a reduction of the risk premium in the future. That's the last draft we got. Like I said before, we haven't come to the final draft yet. We only know more about it next week, Monday, more precisely, Monday.

Q - Operator

Okay, great. Great. Thank you. Thank you very much. For GSF, there will be solution to it. The government stated before that a hydrology risk was a program to be handled by the generation company and the government would not be involved, even the series of cases at court reopened and restarted dialog with the government. We don't know precisely what the final decision will be, but I think it's much better than the 20% expected by year-end.

My question is the following. So, you already have GSF expense with the plants that expired, so you already have the burden and in the future all hydrology risk will go through the captive market because it will become quota. So, the benefit you'll have is the cost coverage you have, to some extent, will come back to you in the future as burden or not, that's my question. So, will you have the R\$30 million back?

We expect to receive it Juliéno (42:24). So and that's not - so this topic has not been fully clarified by the government yet, but we expect our right complied in the first half of 2015. Now, there is something else, the extension of concessions, but they also mentioned

having this through tariff flags. So, this is still being considered. We don't know what a final solution will be though.

Great. Thank you.

This concludes the question-and-answer session. I'd like to give the call back to the management for the closing remarks.

A - Unverified Participant

So, there is a lot of expectation for the second half of the year. I anticipated some data, but despite the whole crisis in the electric industry, we do have good expectations, because our thermal power plant it is at lower levels, but we expect it to be up and running. And we also expect to come to a solution to GSF and we'll do everything in our power to be successful in the building process for Parigot de Souza and Mourão plant.

Taking into account the possibility of having 30 or 40 as part of the energy, so we can sell it in the future in the pre-market or in the regulated market. I guess this is where we have high expectations for the second half of the year. So, we wish you all good afternoon. We thank CEO, Luiz Fernando Vianna, we thank all the manager and officers and we all like to be close to you and the financial market. Thank you very much. Enjoy the weekend.

Operator

This concludes Copel's conference call. Thank you all for joining us. Have a good afternoon.

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