

## Q3 2017 Earnings Call

### Company Participants

- André Dorf, Chief Executive Officer
- Gustavo Estrella, Chief Financial & Investor Relations Officer

### Other Participants

- Giovana Furquim, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good day, ladies and gentlemen. We would like to welcome everyone to CPFL Energia 3Q 2017 Earnings Results Conference Call. Today we have with us Mr. André Dorf, CEO of CPFL Energia, Gustavo Estrella, CFO and IRO, and the other officers of the company.

The presentation will be available for download in the website [www.cpfl.com.br/ir](http://www.cpfl.com.br/ir). We inform you that all participants will be in listen-only mode during the company's presentation. After that, there will be a Q&A session when further instructions will be provided. It is important to remind you 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. Forward-looking statements are based on the beliefs and assumptions of CPFL Energia management and the 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 the results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. André Dorf. Mr. Dorf, please go ahead.

### André Dorf

Thank you. Good day, everyone. Welcome to another CPFL conference call.

Now, soon we're going to assess the results of the third quarter 2017. As usual, we have our quick presentation and then we will be available for questions. Let's just begin on slide 3, please. Here, we have the highlights of the third quarter 2017.

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First highlight has to do with an increase in load measured in the concession area, up 4.2%. We're going to see later, but this didn't happen in an even way. We still see some clients moving to the free market. In addition, we observed a slight reduction in contracted demand, down 0.9% off-peak and down 1.3% peak. We had a significant increase in our net operating revenue and in our EBITDA, part of that increase was related to the acquisition and consolidation of RGE Sul, which appears in our results in a consolidated way in 2017. It was not included in the results of 2016.

Investments amounting to BRL 544 million in the quarter. Our net debt, at the end of the quarter, totaled BRL 13.7 billion, a leverage of 3.24 times net debt over EBITDA ratio in the last 12 months, an adequate leverage level.

In the quarter, we also had CPFL Piratininga tariff adjustment, an average effect of slightly over 17% to be perceived by consumers. In addition, we had progress in the transaction of a position of control by State Grid, we are on the process of its Tag Along Tender Offer. This offer was registered by CVM and the auction will occur on November 30. We also have the launch of CPFL Inova, which is an open innovation program that we created at CPFL Energia in partnership with Endeavor Brasil. We'll talk about that momentarily.

And we also had a quarter and are having a fourth quarter which is quite pleasing in terms of sector. GSF, contract in the pre-market is the thing that was discussed at length; the possible eventual privatization of Eletrobras, discussion of regulatory work; so discussed the hydrology issues. We've had some strong rainfall in Rio Grande do Sul but we have a hydrology below the historic level with an impact on reservoirs, and the public consultation about which we had talked in prior conference calls that aims to improve the regulatory framework of the electric sector in Brazil.

Let us move ahead, slide 4. Here we have a snapshot of our EBITDA and cash generation of the company measured by EBITDA in the quarter. In the quarter, we had BRL 1.275 billion of total EBITDA. I am referring to the top left-hand corner pie chart with the following breakdown: power generation here, broken down into Renewable and Conventional Generation, accounting 46% of total EBITDA of the group; distribution accounting for 48%; and Commercialization Services and others, 6%.

If we start on the right top-hand corner, we see a 13% increase - actually a little over 13% if we compare EBITDA of the third quarter 2017 compared to the same period for third quarter of 2016. This is linked to a market increment and also to the acquisition of RGE Sul.

In Conventional Generation, the second chart, we have the financial restatement of liquidity and where we have the power thermal power plant dispatching mostly by the end this quarter. In Renewable Generation, we have the (00:06:31) projects that are in the few markets that we call ACL complex project. That accounted for this increment of over 18% that we see year-on-year.

And on the left, we see a 6% increase in Commercialization, Services and Others, here which is linked to volume and margin gains that we experienced in the third quarter of 2017 in the yearly comparison.

On slide 5 now, please. Here we give you more on distribution some highlights. We have increased sales in the concession area, up 18% in the quarterly comparison – in the yearly comparison actually, here including RGE Sul. If we are to disregard RGE Sul for comparison purposes, we had an increase in sales in concession area, 3.2%. Increase in load measured in the concession area, up 4.2%, in line with increase in sales. Like I said, we had a slight reduction in contracted demand. In our level of losses in the period, we remained pretty much in keeping with the second quarter of 2017 and compared with the third quarter of 2016.

On the right, we compare increasing load in the concession area without RGE Sul, comparing free market and captive market. And we can see that there is a big difference in the percentages, which reflects the migration that is still happening of captive clients migrating to the free clients, it's down 1.5% in captive and growth of over 17% in the free market.

If we observe sales in the concession area, and here I'm talking about that middle chart, without RGE Sul for comparison purposes, we can see an increase of 3.2% and the same behavior considering free client in the captive market. On the right, at the bottom, we see sales by consumption segment. This growth in sales by consumption segment with the residential is still leading the way, also drove an increment of 2.8% in Industrial, the Industrial segment, and this is good news. We follow the Industrial segment, of course, because they are the drivers of the economy.

Commercial, still lagging a little behind, growing 1% in the quarter, and others, including rural and municipalities, growing 4.5%. And that all together totals 3.2% of sales decrease in the concession area.

On slide 6, we give you more detail on our delinquency. The top chart shows the evolution of allowance for doubtful accounts, ADA as a percentage of our gross revenue. For the third quarter in a row it's been going down and it has reached the historic average.

We have an average of 0.6% of gross revenue, which is good news.

On the bottom left-hand corner, you will see a reduction in over 90 days past due bills as a percentage of gross revenue. Again, it's an improvement. But this is not happening by chance, we can see on the chart on the right that we had additional spending with collection actions and actions to fight delinquency. So the chart on the right shows the amount of disconnections that we had in the third quarter, 490,000 disconnections in a quarter, which is way above the historic average.

On the next slide, we see a snapshot of our performance in Generation. Here, we started with the highlights. Starting with the unfavorable hydrological situation that has a reflex on stock price. It was with a BRL 149 per megawatt hour in September 2016 to BRL 522 megawatts per hour in September 2017, significant valuation. And we also had wind generation a little below P50 of the expected generation, and this is the consequence of wind speeds below the expected, and some one-time off events that caused lower availability.

And if you look at the chart on the left, we see the volatility of spot price. The biggest variations here some movements when the price was below BRL 90 and sometimes reaching a price over BRL 500, it's always depending on hydrology.

In the bottom chart, we show the reservoir levels as a consequence of the hydrology. As we see, the level was quite depressed NIPS reservoir, so as a whole have 18.5% as the reservoir level. And in the Northeast, where the situation is most critical one, we have reservoir levels under 5%.

These are concerning situations for next year, depending on the rainy season that has just started. The top right hand corner chart shows installed capacity. We have an increase in the period given the renewable projects that started operating along there for the next 12 months.

In the following slides, we'll talk about the results. And now I turn the floor to Gustavo Estrella, our CFO.

### **Gustavo Estrella** {BIO 18109709 <GO>}

As for results, this quarter was very positive. If you check the range of our revenues, EBITDA and net income with positive variations year-on-year. Not only in the results, but also in all business, the major business of the group, all of them show positive variations vis-à-vis 2016.

Let us start the explanation with the main variations of EBITDA. In the Distribution segment, variable positive at BRL 57 million. Our main variation here has to do with market growth. So once again, we grow more robustly in the market, growing by 3.2% in concession and 4.4% in the Residential segment. So we can also see a positive effect in the average tariff and also in margins for the Residential segment vis-à-vis the total average.

We also have the consolidation now for the full quarter of RGE Sul with an increase in EBITDA at BRL 72 million, partially offset by an increase in PMSO. It is a regular increase vis-à-vis transfer of inflation rate year-on-year, but also an increase in the enforcement of collection actions.

More specifically, to control delinquency and also variation of concession financial assets, basically showing a reduction in IPCA in 2017 scenario vis-à-vis 2016. As a reminder, this is not a cash impact, but only a restatement of our asset for accounting purposes, another negative variation of BRL 9 million in Itaipu's exchange variation.

For Conventional Generation, also positive at BRL 30 million, and basically due to financial adjustments of UBP. Once again, this is a liability path to inflation and the inverse effect because it's a liability, but whereas inflation we have less restatement and, therefore, a positive impact at BRL 70 million. It passes performance. It passes our TPT with higher dispatch compared to what we saw in 2016, also with an increase in margin at BRL 12 million to the group.

For commercialization, a positive variation of BRL 4 million. Two different effects: firstly, the most significant effect, commercialization progress in the group, particularly in this area of energy increasing not only volume but also margin. At the end of the day, it brings a positive impact on results compared to 2016 of another BRL 34 million. And also contractual penalties in 2016. We had a penalty from CPFL Renováveis of BRL 23 million. This penalty was a non-recurring effect of 2016. It doesn't happen in 2017 and now a negative variation of BRL 23 million.

Still about EBITDA, now positive variation also for CPFL Renováveis, total variation of BRL 63 million. The main impact comes from the start-up of new wind farms in the group with installed capacity and an increase in EBITDA of BRL 92 million for CPFL Renováveis. The same penalty that was paid in 2016 for CPFL Renováveis does not happen over 2017, positive impact at BRL 37 million for CPFL Renováveis. The impact of GSF, basically GSF of energy sold in ACL with a negative impact at BRL 27 million. As a reminder, CPFL Group, every sale of ACL Energy agreements with the insurance has no exposure to GSF.

We also have the negative impact of lower generation from wind farms, a variation of BRL 23 million. We already begin to perceive a recovery in the wind level starting October, so we expect that in the fourth quarter, we already see a more neutral effect vis-à-vis the wind curve and seasonalization of our SHPP, a variation of BRL 10 million and seasonality effect will be offset over the year.

As to net income, a positive effect, a BRL 122 million, mostly comprised of a reduction in the arrivals of CDI, our debt is very much pegged to CDI. You will have additional benefit with a lower interest rate in the country. Another positive impact of mark-to-market of BRL 43 million and finally, a positive effect of Itaipu's exchange variation at BRL 9 million.

We also have an increased indebtedness due to the acquisition of RGE Sul comparing 2016 to 2017 and now, the impact naturally shows an increase in financial expenses related to financial results coming from the asset, RGE Sul and also contracted through the acquisition of the same assets.

On the next page, let us talk about indebtedness. Indebtedness is pretty flat and stable since 2016, around 3.2 times net debt over EBITDA ratio. Our expectations show a sign of lower leverage for coming quarters. As to cost, it is important to say that the reduction of the nominal cost of debt closing the third quarter with a cost of 9.1% of the debt. We also expect the curve to keep on going down as interest rates in Brazil keep on going down. So we expect to see new reductions in financial expenses owing to the reduction curve of CDI.

Now, in the pie chart on the right, we can see 74% of the company's debt pegged to CDI. Naturally, interest rates drop, always being a positive impact on financial expenses.

As to our liquidity, debt amortization schedule, so we can see a very robust and comfortable cash position, this quarter, BRL 3.8 billion. Today, we already consider refinancing of maturity for 2018 fully addressed and also for 2019. And once again, short-term is very comfortable when it comes to the company's cash position.

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On slide 11, let us talk about our SHPP under construction Boa Vista II, expected to start-up in 2020. Already under construction, on schedule, no expectation of any kind of delay or any costs exceeding our CapEx expected for this project, 29.9 megawatts of installed capacity. The project was sold in the auction in 2015, so fully on our schedule that was originally set.

On slide 12, some comments on CPFL Inova program. It's a partnership between CPFL and Endeavor. So, basically, this is to foster and encourage the development of new technologies, new innovations, partnering with Endeavor for CPFL Energia. So the idea of the partnership is to select up to 12 projects of start-ups and scale-ups. So, we can internally an in-house develop in CPFL as a private study to implement our projects.

And then later on we want to bring new technologies in areas that are very interesting to the company in the coming years.

Last, but not least, on slide 13, some comments about the acquisition of State Grid, our transaction. To give an update we have the approval on December or October 26 by CVM, all the documentation required so we can move forward with the Tender Offer. So, the Tender Offer is planned and expected to happen on November 30. And on that date, we'll complete the whole process of acquisition involving State Grid and CPFL Energia. So, we have the mandatory Tender Offers registration under the same conditions, sales conditions of the control block that we had early this year.

So now, we will give the floor back to the operator so we can begin the question-and-answer session.

## **Q&A**

### **Operator**

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Giovana Furquim with Itaú BBA. Giovana, you may proceed.

### **Q - Giovana Furquim**

Thank you. I have two questions. The first has to do with the tender offer that is expected to happen on November 30. Simultaneously, we will have the tender offer for Renováveis. There was an issue of valuation.

And my second question has to do with management. Considering that there is the Tag Along, but considering that State Grid is already in the control, I want to understand, will there be any changes in the management of the company? Are they more present regarding approvals? I would just want to know more about how they are behaving in terms of management.

### **A - André Dorf**

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Giovana, regarding the first question. The processes began simultaneously for CPFL Energia and CPFL Renováveis. They have their own dynamics, though, and the fact is that at the end of month, we are going to have the auction for CPFL Energia and we haven't had a request for registration approved by CVM for CPFL Renováveis. So the processes started going in different paths. So what we can expect at the end of month is the auction for CPFL Energia. Although the two processes are separate now, (00:25:25) is providing additional information for CVM, so that we can also have the tender offer for CPFL Renováveis.

Both processes are unfolding well at different places. And your question about managing the company, we did have a change in the composition of our board of directors. State Grid has a seat in the board and we do have some executives here, but this does not influence or it didn't change in anyway the way we are managing the company. So in a sense that authorization, methods for approval presented by the executive management, the board, and the shareholders continue unchanged. We continue with the same flow and the same decision making process that we've had in the company. So, we are working as business as usual. Thank you.

## Operator

This concludes the question-and-answer session. We would like to turn the floor back to Mr. André Dorf for the closing remarks.

## A - André Dorf

So, during Giovana's answer, I said we were in business as usual just by the ongoing offer by shareholders. And this is something involved in shareholders. So, the company in this regard keeps on enhancing its processes and improving management of different businesses that may have its portfolio. And also, getting ready in order to address challenges faced by the whole country, and at the same time benefit from opportunities still offered by different segments of the electric system. We are watching the progress very closely. All the regulatory discussions have also paid keen attention to all opportunities in terms of capital structure, cost of debt in Brazil.

And as a result, improving the results of the group as shown in the third quarter of 2017. So we keep on being very diligent and also enhancing the company's management. Thank you very much for joining us today at this call. Good day.

## Operator

This concludes CPFL Energia conference call. Thank you very much for being with us. Have a good day.

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