

Q4 2017 Earnings Call

Company Participants

- André Dorf, Chief Executive Officer
- Gustavo Estrella, Chief Financial & Investor Relations Officer
- Luís Henrique Ferreira Pinto, Vice President, Regulated Operations

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and thank you for waiting. We would like to welcome to CPFL Energia's Fourth Quarter Earnings Results Conference Call. Today, we have Mr. André Dorf, CEO of CPFL Energia; Gustavo Estrella, CFO of CPFL Energia and other officers of the company.

The presentation will be available for download at the website, www.cpfl.com.br/investorrelations. We would like to inform you that all participants will be in listen-only mode during the conference. Afterwards, there will be a question-and-answer session when further instructions will be given. It is important to mention that this call is being recorded.

Before proceeding, we would like to mention that forward-looking statements that might be made during this call regarding the business prospects of CPFL are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties, and assumptions as they refer 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 affect the future performance of CPFL Energia and may 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. André Dorf. Mr. Dorf, you may proceed.

André Dorf

Thank you very much and welcome everyone to this conference call during which we will be talking about the fourth quarter of 2017 and the full year of 2017 as well. First, we would like to make a brief presentation and then we will be available to answer your questions.

Starting by slide number 3, we have the highlights for 2017. The first highlight has to do with the load measure in our concession areas, net of RGE Sul due to the fact that it was

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integrated to the group in November 2016. So in order to make the comparison valid, we excluded from this from the analysis. So our load measure in the concession area went up by 2.2% over 2017 and later on we will have more details about that. Very well.

As you saw, we had a very - we had a transition in our corporate and also with the integration of RGE Sul and the grouping of concessions and our team was very much focused on the operating aspects and the delivery of results over the year. As a result of that, we had an increase of almost 40% in our net operating revenue and almost 18% in the EBITDA in the period.

It was a very intensive year, almost BRL 400 million and over BRL 2.6 million in 2017. This was a record investment made by the company in the history of the company. Our net debt remained comfortable with the same financial discipline. And so by the end of the year, we delivered 3.2 times to EBITDA and the leverage indicator. So we continue in this trajectory of deleveraging the company.

As we said before, we had the integration of RGE Sul in 2016 from the viewpoint of systems and the team and operating practices. And the company is already fully integrated with the CPFL company. Next, the grouping of concessions. We grouped five concessions with the permission of ANEEL and now we have one single concession called CPFL Santa Cruz which brings the operating benefits and also efficiency gains for the group.

We had over the third quarter a tag-along tender offer, CPFL Energia, and the auction occurred on November 30. And the State Grid now holds almost 95% of the shares issued by CPFL Energia and other relevant sector issues that were in the agenda for the fourth quarter. Some of them are still in the agenda for this year, GSF for the free market. This is a thing that has to be solved, and this is the last regulatory issue to be addressed. And also Eletrobrás deserves to be highlighted. The sale of the - they're north and Northeast and also the Democratic capital of Eletrobrás has been discussed at Congress.

We had important discussions also about the regulatory act, a very sensible decision, a very balanced decision by ANEEL. And because of that, we continue with our 8.09% WACC. And this is a very positive conclusion of this subject for everybody involved, the investors and the company and the credibility of the regulator, everybody has won with this decision.

And also, we have a Law Project, Public Consultation 33, a bill of law in fact with the objective of modernizing the regulatory environment and the regulatory framework of this electricity sector with changes linked to distributed energy and renewable energy among others, certain technological changes that have to do with this sector. So this is a very important theme for the sector, and that should be debated over the next few months.

Now, turning to the next slide. Here, we show highlights of the quarter in the year starting on the pie chart to our left. We see the breakdown of the EBITDA for the fourth quarter. That has already totaled almost BRL 1.4 billion. In this, BRL 1.4 million, 49%, was allocated to distribution and energy. So the distribution business addressed almost half of the

EBITDA in the quarter, followed by renewable and conventional generation and commercialization and other services with 3%.

Now, turning to our chart to the right, we see a significant increase in the EBITDA for distribution. Thanks to the integration of RGE Sul and, in addition, to the market recovery. We had in the year a growth of 21% in the distributions EBITDA, almost BRL 200 million; and conventional generation, a growth of 8% in the year; and renewable, 23%. So if we add conventional and renewable generation together, we have almost BRL 300 million of EBITDA gain. Therefore, very well balanced out over the businesses. And commercialization services and others also significant growth, higher than 17% year-on-year.

Now, the message that we wanted to leave with this slide is that we had operating improvements and gains of EBITDA in all the businesses of the company. So it was not an isolated recovery of EBITDA.

And page number 5, the next page; we talk about the behavior of the market in energy distribution. So starting by the qualitative side of the slide, there was an increase in the concession area of 8.7% for the quarter, very much influenced by the integration of RGE Sul. And net of RGE Sul, this was 4.8%, a very important improvement. And also, we continued in the trajectory of improving our technical and non-technical losses for the company. We had 8.81% of losses in the fourth quarter, relatively better than in the previous quarters.

And looking on the right side of the slide, we have the load measured in the concession area net of RGE Sul, so growing 5.4%. And now, if we look at a lower part of the slide, we will see the sales during the same period with RGE Sul to the sales compared with the indicator, very close to the load that we saw in the concession area, 4.8%. And here on the right, you can see that all classes of consumptions had recovery over the period. And I would like to mention specifically the industrial class with the growth of 5.6% and that this is the driving force behind the economy. So we see a major recovery here in the fourth quarter.

On page number 6, we talk about the same indicators but now we are talking about the full year of 2017. So let's start at the middle of the slide, sale in the concession area without RGE Sul, 2.1%

increase. And on the right, you can see the growth in consumption classes over 2017. And as you can see, all of them are delivering recovery after some years of dropping. So highlight here for the industrial and the residential areas.

In the pie chart, on the lower part of the slide, you see the market profile, the market breakdown. So you can see the distribution of our sales over the year, industrial accounting for almost 40% percent of our market followed by residential with almost 30%, commercial and other segments such as rural and city administration and other classes.

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On the right - on the lower right of the slide, we compare our performance to other regions. So if we look at the numbers, we see 2.1% of sales in our concession area vis-à-vis the sales in Brazil as a whole growing by 0.8%, so our region delivered the best performance. And comparison with the Southeast, we had 2.1% vis-à-vis 0.3%. And operations in Rio Grande do Sul, 2.6% vis-à-vis 3% in the South region.

On the next slide, slide number 7, we show the behavior of delinquency and ADA evolution as well. So, the evolution of our ADA as a percentage of the gross revenue continues on a downward trend. As you can see on the upper part of the slide, we had a peak in the second quarter of 2016 where we had a 0.9% indicator of our gross revenue in ADA, and in the last quarter of last year, 0.57% going back to the historical average of this indicator.

Of course, this was not for free and the company has been making a huge endeavor both on the operating and financial side in order to fight delinquency and to fight fraud as well. So, if you look at the bar chart, our collection actions, one of the collection actions is the disconnection. And still, we have it's either much higher than what was desirable, 407,000 disconnections in the quarter. And during the first quarter of 2018, the situation continues to be the same. So, there is not a very big improvement here. So, on the left, you see the total above 90 days past due bills as a percentage of revenues also going back to historical levels, that is to say, show improvement.

On the next page, we show some indicators related to generated GSF posted in 2017. And here I mentioned that the GSF continues to be an issue to be tackled mainly in the free market, but in fact we had a high GSF in 2017, almost 21%. Also, a challenging year for wind generation, minus 11%, vis-à-vis the P50 and in our case, we had two major factors to achieve this result. First, it was the speed of wind that was lower than expected in some of the regions; and secondly, a lack of availability in some pieces of equipment due to the replacement of a relevant supplier in the operation and maintenance activities of some of the wind farms.

So those replacements led us to have a lack of availability of some pieces of machinery, and this had an impact and leading to this negative impact. So here the spot market - the high volatility of the spot market prices and the volatility continues in 2018 mainly in the last few days when we had a very high volatility. Installed capacity on the right, with a slight increase mainly due to the increase in renewable energy, and the lower part of the slide we showed the level of the reservoirs. And this was a very critical theme in the second half of last year.

But we had a recovery of the rainfall levels in the last few months and the message is that today we are over 40% of the average level of reservoirs in the national interconnected system and the NIPS still lower than the 60% historical average but already higher than the critical years that we have in this decade. So a recovery here, so it's no longer a critical theme from the viewpoint of supply in the short term.

On the next few pages we talk about the results and now I would like to give the floor to Gustavo Estrella.

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Gustavo Estrella {BIO 18109709 <GO>}

On page number 9, we see the result of the fourth quarter with very positive results both in the line of the operation and EBITDA growing by 36%, BRL 363 million. And also the last line, net income, an increase of 262% vis-à-vis 2016, reaching BRL 498 million.

What we see here are the key factors for each business of the group. So we start with distribution with variation with the highest effect which is the effect of market growth. So we see in the market an increase and also the effect of the tariff adjustment for the companies over the year. So we had an increase in our result of BRL 118 million. We also have the effect of the consolidation of RGE Sul. We acquired the company in November 2016.

And during this quarter, we see a consolidation of that, bringing a positive effect of BRL 83 million. We also had the appraisal report at the RAB CPFL Paulista base with an effect that was confirmed at the beginning of this year vis-a-vis December 17. It's BRL 63 million positive result and also a variation on the financial assets of the company index to the IPCA. So we have the IPCA for the quarter higher than the quarter of 2016 - the same quarter in 2016, with a positive net balance or effect of BRL 56 million and also the effect - let's talk about the - also the effect of inflation under PMSO due to the adjustment of the contract and also the collective bargaining agreement with a growth of BRL 20 million in this line item and also we have a provision for contingencies, basically labor and legal in November 2017, machine and line maintenance that we carried out over the full year of 2017, and with an impact on this quarter of BRL 15 million on the overall result of the growth.

Personnel growing by BRL 13 million, basically, these are the layoffs that we did in 2017. There's a positive impact in terms of cost reduction in our payroll as of 2018 and also a process that has to do with the tariff reviews, which is the increase in our CapEx. As was said before by André, the highest ever CapEx in the history of the company. But together with that, we have a write-off of assets in this quarter with an impact of BRL 6 million.

Renewable energy, total variation of BRL 85 million. So we had a lower provision in 2016 that we didn't have in 2017. So this is a positive variation by BRL 48 million, and also the start-up of wind farms, of the ACL wind farms, increasing by BRL 27 million in the result of the fourth quarter.

Conventional generation, basically, a seasonal effect of the GSF. So we have a very short exposure or small exposure to the GSF. So we had a negative variation of BRL 25 million. And when we go to the variation of the full year, this variation is practically non-existent.

Now, turning to our final line, the net income result. We have a positive effect in our financial results, and that is impacted by the interest rates that are lower. And we have here BRL 164 million in this quarter. We also have the consolidation of the RGE Sul, which also has allowed us to have a positive effect because of the interest rate variation this year within BRL 20 million. But obviously with the increase of the indebtedness because of the company's acquisition, we had financial additional expenses of BRL 34 million.

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Now, turning to slide number 10 and now talking about the results for 2017, the whole year. Here, once again, just in line with the fourth quarter's result, we have positive results again with a growth of almost 18% in our EBITDA and 41% in our net income. And the key factors here are in the EBITDA, a total variation in the distribution of BRL 390 million. The main variation here is the positive effect from RGE Sul, almost BRL 300 million in 2017 vis-à-vis 2016. Obviously, in 2016, we had only two months of EBITDA of that company and now we have 12 months. But here we should highlight an increase of the results of this company when we look at the whole year of 2016 vis-à-vis the whole year of 2017, the 12-month base.

So we have RGE Sul. We have EBITDA of BRL 355 million. We also have a positive effect in here, not as much for the market growth, but we had a market growth of 2%, but a significant increase because of the transfer of tariff adjustments in 2017 that has allowed us to have a combined effect of BRL 256 million more in our results.

Itaipu exchange variation is in our final line. We also have a positive effect here of BRL 36 million and we bring that back to the financial results. Our allowance for doubtful accounts also has an important evolution in the program to delinquency in the group. We had a reduction in our ADA of BRL 36 million. I think this is very positive.

Also, there is a private pension fund effect of BRL 29 million with a variation of interest rates in our pension fund plan, and this is because of the reduction in the interest rate and also variation of PMSO minus BRL 228 million. I would say that almost half of that is just because of price adjustment, whether by the inflation or collective bargaining agreement, and that is BRL 96 million.

Also, we had maintenance of machines and lines/networks, BRL 32 million. And we have the carryover of prior years and the postponement of maintenance that now have been done in 2017. So we have an extra BRL 32 million in maintenance expenses. Legal and judicial expenses, BRL 24 million. This is the provision for December of 2017 basically of some labor losses that we had at the end of the year.

Losses in here - and the write-off of assets. Once again, there was an increase of our CapEx over 2017 and the preparation of the company for that process of tariff review that's going to happen now in 2018. That ends up impacting the assets write-off in BRL 22 million. Personnel expenses BRL 18 million. Basically, this is a program that we have carried out because of the idetment cost and it does have an important effect in our EBITDA. And finally, addressing the collection actions here, we were able to reduce delinquency but we still demand collection actions and therefore there is the increase of OpEx. And here we have an impact of BRL 9 million in the year.

Now, turning to renewable generation, there was a total variation of BRL 228 million. The main impact here is the start-up now ready for 12 months for 2017, the wind farms that started at the end of 2016 and we have a positive result here of BRL 179 million. Also, there was a price adjustment, transfer of inflation rate, I mean, IPCA rates, in our contract of energy sale and that is BRL 70 million.

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Contractual penalties paid by separate element of August in 2016 and that did not happen in 2017. It was a one time-off situation for 2016. And so, that has an impact of BRL 53 million for the comparison. Also, we have seen lower wind farms generation, almost 11% percent below the P50 curve. Therefore, we have a negative impact of BRL 32 million. Also, there was a lower biomass thermal plant generation of BRL 20 million in the results. And here for (27:00) we have some exposure to GSF because of our SHPP was an impact of BRL 18 million.

For conventional generation, there was a positive variation of BRL 89 million, basically because of contract adjustments and the IPCA adjustments as well in some contracts that we have. And so, we did have margin gains by price of BRL 39 million. Also, financial adjustments of the UBP was BRL 30 million. Once again, the inflation variation here including a smaller inflation in 2017 than in 2016. So we have a lower adjustment, therefore we do have a positive result of BRL 30 million. And also EPASA, our oil thermal power plants that had a dispatch that was higher in 2017, higher than in 2016, therefore we have a positive margin. And the more generation we have, the better our results, therefore, the impact in there was up BRL 25 million positive.

Now, in commercialization, there is BRL 31 million variation, a positive one, thanks to two main topics. The first one, the margin gained by price and volume of our commercialization company, and they were partially offset by the contractual penalties from 2016. We did not have those penalties in 2017, and that amount was BRL 57 million penalty.

Now, turning to our net income, there was a financial result variation of negative BRL 34 million. The main impact here was really the reduction of interest rates. And therefore we have a positive result here of BRL 365 million of debt charge and net income from financial investment. But we do have RGE Sul consolidation of BRL 74 million in our financial expenses and the acquisition, so that - so there's an additional financial expense of BRL 186 million.

So we do have also our derivative and our position in the foreign currency represents here a variation of BRL 49 million that is negative. And remember, here we have two positive effects in 2016. We had the results of the derivative of BRL 68 million and now also positive of BRL 19 million, so negative variation of BRL 49 million.

We also have an important effect in our financial results which is the reduction of the revenue of debt installments in consumers of BRL 36 million. That is because of the lower interest rates. And with lower interest rates, we are also turning a lot of our customers. And also we had Itaipu's exchange variation of BRL 36 million negative as well.

Now turning to slide 11, we have our investment. We are ending the year with a net debt of BRL 14.5 million with a leverage that is clearly going down at 3.2 times our net debt over EBITDA. That is very important vis-à-vis our covenants of 3.45 and so we have this result at the end. And the growth that cost you see a correlation of the CDI drop which is over two-thirds of our debt, and our debt is an indexed by the CDI. So you see a drop and

the drop trend in that interest rate and also in our debt, and that should continue over 2018.

Now turning to slide 12. Basically, we talk about the liquidity of the company. So we end 2017 with a cash of BRL 2.9 billion. If we analyze our short-term debt in spite of the cash of last year, we have funding of BRL 2.800 billion that we were able to get in the beginning of last year. So we are at a very comfortable situation with enough cash to cover all our future and short-term maturities. So we are already working for 2019 and 2020. Our average tenure is 2.6 years. So you always have the concentration of short-term maturities. And we're always working with the rolling over of these centers to avoid any type of concentration and any risks of liquidity to the company.

Now turning to slide 13. Today, we have in CPFL Renováveis, our SHPP Boa Vista under construction. This is a project that is going according to schedule. It should start operations in 2020 and we have contracted financing already signed with the BNDES. This is a process that had no surprises and we expect to have it ongoing as scheduled.

Now, on page 14, we show that our investment plan up to 2022 is once again - will leave our record of investments of June 2017 of BRL 2.6 million and it still have an express of a significant volume of investments especially in distribution and investments are still at BRL 1.8 million to BRL 2.2 million in the year - per year. So for the group, a total investment in five years is going to be BRL 10.4 million. So this is really our challenge to maintain the investments in the company at high levels.

And finally, here on slide 15, as we mentioned, we have the grouping of our five discos. At the end of last year, CPFL Santa Cruz will have just one tax ID number and one concession. And we have some synergies here for CPFL. So we have the figures of the company with almost 450,000 customers with 208,000-gigawatt sales within the concession area, and almost 21,000 square kilometers of concession area; almost one-third of CPFL Paulista e, our largest distributor.

Well, we'll now turn the floor back to the operator to start our Q&A session.

Q&A

Operator

Ladies and gentlemen, we will now start the Q&A session. We have a question from (36:02).

Hello, everyone, André and Gustavo. Actually, I have three questions. I just would like to start by understanding the growth of the technical losses at RGE Sul. If that is going to turn into a trend and what are you doing to bring it down?

Second, I would like to understand the evolution of your OpEx. We have seen that in 2017 there was an increase in there, and I would like to know how you are going to address

that line over 2018. And, finally, what do you forecast for volume growth in the first quarter of 2018. These are my three questions.

A - Gustavo Estrella {BIO 18109709 <GO>}

Hello, Juliano. Talking about OpEx, we understand that we did have some non-recurring effects that have affected our OpEx in 2017, not considering that effect because this is a recurring one. We will have then smaller transfers starting in 2018. I think it's important to say that today we are starting a new cycle. Our ZBB process, just to remind you, that we have started with ZBB in the company in 2011. ZBB has a cycle that usually takes around five to six years. So we feel that now is the time of having a new wave of the ZBB process, not only because of the natural flow of processes, but also because of the changing process that the company has gone through in the last few years especially with the growth, new companies, and new projects and so on.

So we feel that right now this is our moment and we have a positive expectation of aiming for new productivity gains, new synergies so that we can have a positive effect in our OpEx curve in the next few years. Just to remind that we have very one-time effect that happened in 2017, but we do have challenges too in terms of looking for market activity starting on 2018.

Now, addressing your volume question, we had - and I think at the end of last year, as we have shown, there was a significant growth in terms of market growth, market increase close to 5%. And what we have here is that the industry is still reacting to a growth similar to what we had in 2017. And what we see that is especially in the low voltage, this is an important fact that temperatures especially February. February was a month that was different from the average and it allowed us to have a reduction in consumption. And we're starting to recover now in March. So, by March, we have a different situation with the increase of the average temperature, therefore, with the positive factor in the energy consumption for our low-voltage customers.

And the third question?

A - Luís Henrique Ferreira Pinto

Hello. This is Luís Henrique, VP of Operations. About the losses, they were more or less in line to what we had forecasted. But there was a slight increment because of the conditions in Rio Grande do Sul and especially as RGE Sul where it serves a matter what region close to Porto Alegre. That is where we have that situation because of the macroeconomic situation that end up affecting our losses. But we are already working on it. And in this year, we are working for RGE Sul. This is a year for the company's integration. And now, it's going to have the same practices as the Specialty Group had. And we are already preparing a full action plan to address these losses and bring them down to acceptable levels, increasing the number of inspections of disconnections and developing an operating method as we work within the Specialty Group.

Operator

Right now we end our Q&A session. I would like to turn the floor to Mr. André Dorf for his final remarks.

A - André Dorf

Very well, we had a year, as you could see, that was very intense. In the Specialty Group, we have a transition in our controlling shareholder. We have several operating initiatives and also the integration of RGE Sul that Juliano has just asked us about in our Q&A session. We have the grouping of the concession and we had several organizational redesigns in the company. But even then we were able to keep our focus in the operation and the daily management of the company and also deliver consistent results.

At the same time that we looked at the operations and our daily activities, we were also able to have the largest investment of the company in distribution, generation, and transmission. Therefore, I would like to stress the operations and how robust they are. And as to the company, as we have been growing and we have been having consistent results in the different businesses of the company, and that is the idea for 2018 as well, to keep on focusing on the deliveries whether revenue and market, whether expenses costs as Gustavo Estrella has mentioned.

So thank you very much for the trust of the shareholders in 2017. Thanks to our employees and partners for another year of good results at CPFL. Thank you very much and have a nice day.

Operator

The conference call of CPFL Energia has ended. Thank you very much for your participation and have a nice day.

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