

## Q4 2016 Earnings Call

### Company Participants

- Andre Dorf, CEO
- Gustavo Estrella, Chief Financial and IR Officer

### Presentation

#### Operator

Good morning, ladies and gentlemen. Thank you for waiting. We would like to welcome everyone to CPFL Energia Fourth Quarter 2016 earnings conference call. Today, we have with us Mr. Andre Dorf, CEO of CPFL Energia, Mr. Gustavo Estrella, CFO and IRO. And other officers of the Company.

This call is being broadcast simultaneously on the Internet at [www.CPFL.com.br/ir](http://www.CPFL.com.br/ir). You can also find the banner through which the presentation will be available for download.

We inform that all participants will be in a listen-only mode during the conference call and the Company's presentation, after which there will be a question-and-answer session. (Operator Instructions) It is important to mention 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's management and on information currently available to the Company. Forward-looking statements are not guarantees of performance (technical difficulty) 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 results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the floor over to Mr. Andre Dorf. Mr. Dorf, you may proceed.

#### **Andre Dorf** {BIO 15460232 <GO>}

Very well. Good morning. Welcome, everyone, to CPFL's conference call to address the results of the Fourth Quarter 2016. And we will speak a little bit about the full-year 2016. As usual, we have a brief presentation, after which we are going to be available for the Q&A session.

Let us begin on Slide three please, where we can find the 2016 highlights. This was quite a busy year for the CPFL Group. Starting with the market, we had a reduction in the load measured in our concession area along the year, down 3.3%. Our contract demand, this is actually positive use remained practically stable, preserved, compared to the same period of last year, which shows that our high-voltage clients did not reduce their contracted demand. But they reduced the load.

As for our revenue, we have a 7.2% reduction in net operating revenue for 2016 and EBITDA remains stable. This revenue reduction actually translates a reduction of charges low-cost energy that is passed through to customers, to consumers. This is good news for customers and not necessarily bad news for CPFL. This is the price of energy to consumers.

We remain confident in Brazil. In the Fourth Quarter, we invested almost BRL700 million and almost BRL2.3 billion around 2016. These were investments in distribution and generation of energy.

Net debt at the end of the year totaled BRL13.2 billion, however with a lower leverage. Even with these investments and with the measures to deal with the crisis, we were able to lower our leverage to 3.2 times net debt over EBITDA for that period. So this was an improvement compared to prior years.

We also had a commercial start-up of Campo dos Ventos and Sao Benedito wind farm, adding 231 megawatts in our installed capacity. In addition, we began the consolidation of RGE Sul in CPFL Energia. This was announced in the end of the First Quarter of last year and it was completed in November of last year. The integration is underway. A number of processes have been mapped and we are proceeding with the integration and we are consolidating the integration of RGE Sul. And it's going quite smoothly.

Another very important step for the company was the sale of CPFL Energia's control to State Grid who sold -- there were for sale of stakes of Camargo Correa, Previ and Bonaire announced in July of last year. And that actually happened in January 2017. And for the 12th consecutive year, they were able to position CPFL Energia in BM&FBOVESPA's Corporate Sustainable Index ISE. So another positive highlight for the Group for 2016.

Let us move to Slide four please. Here we see our EBITDA breakdown. Our cash generation is measured by EBITDA in 2016. EBITDA totaled BRL4.126 billion in 2016. And the breakdown, EBITDA breakdown, is in this pie chart on the top left-hand corner. We can see that the distribution business accounts for -- or accounted for 45% in 2016, generation in here, conventional and renewable generation 51%. And there's lots of other businesses growing in the group accounting 4% of CPFL's total EBITDA. So there's a balance here between distribution and generation.

If we are to analyze business by business with, again, the distribution in the top right-hand corner, we can see that, along there, there was a 14% reduction in EBITDA here mainly explained by a reclassification of accounts in our income statement where we reclassified the financial assets. This reclassification helps the 2015 numbers. And that's why we have

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a difference of slightly over BRL200 million year-on-year. In conventional generation, an important increase, almost 25%, very much based on contract adjustments for our generation contracts.

For renewables, EBITDA remained practically stable comparing 2015 and 2016. And this was negatively influenced by some write-offs of assets of projects which were discontinued amounting to approximately BRL75 million. Even with this impact, EBITDA remains stable.

And the positive highlight is on the bottom left corner, almost a 40% increase in our commercialization and services activities in the Group. This was positively influenced by a contract indemnity of about BRL57 million.

Slide five please. Here, we have some information about energy sales in the quarter. I will begin talking about the Fourth Quarter now. We had an increase in sales in our concession areas of almost 7%. It's not that the areas improved in terms of consumption or that there is no price. But this number reflects the addition of RGE Sul in the months of November and December. If we were to exclude RGE Sul, load fell in our concession area down 3.3%. And our sales dropped again 3.3%. So our market contracted 3.3% in the Fourth Quarter 2016 compared to the First Quarter of 2015.

Contracted demand, as I mentioned, remained stable and our losses increased slightly here. They were at 8.37% in the Fourth Quarter 2015, increased to 8.84% in the Third Quarter of 2016. And in the Fourth Quarter of 2016, 9.08%, due to the change in the market mix, given that industrial high-voltage clients have contracted more. Thus, we now have low voltage that has higher loss rates, technical and commercial alike. And also because increased slightly here. They were at 8.37% in the Fourth Quarter 2015, increased to 8.84% in the Third Quarter of 2016 and in the Fourth Quarter of 2016, 9.08%. Due to the change in the market mix. And also cause of the prices, more of those connections increase, more initiatives to fight the (inaudible) increase and initiatives of energy back along the network and initiatives to fight those also increased. And that's why those were the drivers to account for the increase in loss.

If you look at the top right-hand corner of the graph, here we have loads in the concession area. We mentioned down 3.3% or a 3.3% retraction compared to the Third Quarter. And we can see migration of many clients from the captive market to the free market. We have 8.4% reduction in the captive market. And an elevation of more than 11% of load in the free market in our concession area.

Now, looking at the bottom middle chart, this one excludes RGE Sul. Just for comparison's sake, we have the same minus 3.3%, in line with load variation. And here we are talking about sales in the concession area. And we see the same behaviors seen in the free and captive markets.

On the right bottom chart, we have sales by consumption segment. We see the residential segment of consumers retracted almost 2%. The negative highlights go to

industrial clients and commercial clients with about 6% contraction. And others, maybe hauls, etc., increasing almost to 4% but with a lower share in the mix.

Moving on, Slide 8, we have similar information. But now the 2016 full-year, no longer concentrating on the quarter. Now it's the full year. Starting on the top left-hand corner, we have again a reduction of 3.3% of load in the concession area. This is more seen in the captive market, the same phenomenon that we saw in the Fourth Quarter.

Here in the middle chart, we can see the pie chart. Analyzing the market breakdown in our markets, almost 40% industrial clients followed by residential, 29%; commercial, 17% of our market.

On the right top where we have the maps, we compare sales in our concession areas with what happened in other regions. For example, where we see the map of Brazil, Brazil on average suffered a 1.2% contraction. We at CPFL Energia minus 3.5%, again due to our industrial commercial mix. These two segments having an irrelevant share. In the Southeast region, we have similar behavior. The region as a whole contracted 2%, CPFL Energia minus 4.4%. Again, this is a more industrialized region. And in the South, we have the opposite. The southern region contracted 0.07% and CPFL Energia increased 0.7%. So this was the behavior of our concession areas compared to the regions where we operate.

In the bottom middle chart, we have sales in the concession area. And here without RGE Sul. Just for comparison's sake, again a retraction in the full-year of 3.5%. The effect of the political and economic crisis, quite perceptive here in the -- are influencing our areas of operation. On the right, we have that same graph that I showed you, sales by consumption segment. And again, here we can see the negative highlights going to the industrial and commercial segments, industrial segment with an almost 8% retraction along the year. This is quite substantial for a segment that does have a big impact on the economy.

Moving on, Page 7, here we can observe some data related to delinquency. On the top left and corner chart, we show you the evolution of our allowance for doubtful accounts, ADA, as a percentage of gross revenue. We ended the year with 0.7% in the last quarter of 2016. But what is worth noting here is that we have a historical average of 0.58%. But as of 2015, Second Quarter 2015, we can see more points above the average in comparison with points below the average prior to 2015. So since 2015, we see an increase from 0.50% to 0.60%, 0.65%. And this stems from the economic prize. The same effect is seen on the bottom left where we show you the total overdue bills more than 90 days past due. Here we can see an up curve. And the good news is that it seems to have stabilized. CPFL in the last quarter stabilized at about 1.05%, 1.09% of revenue. So it is stabilizing but stabilizing at a somewhat higher level than what we observed before the crisis.

So what are we doing with all of this information? Well we are intensifying our collection actions. On the top right-hand corner, we can see the collection actions regarding those connections. If we look at 2015, that's when the crisis began. That's when we started to

see the crisis was going to be deepening. We had 140,000 disconnections in the First Quarter 2015. Now, we stabilized at around 340 disconnections for the quarter, quite a significant number of cuts or disconnections.

Moving on, we are now on Slide 8. We are talking about highlights for our generation business. And here we see the highlights for the Fourth Quarter. Again, we are facing a challenging, unfavorable hydrological situation, particularly in the Northeast region. The indicators are showing some concern regarding CPFL. We have the commercial startup, as I mentioned before, of Campo dos Ventos and Sao Benedito wind farms to 131 megawatts by the (inaudible) CPFL Renovaveis and for the Group. We have good news here. A significant reduction of GSF expenses for the Fourth Quarter 2016. We had minus BRL16 million versus BRL86 million in the Fourth Quarter 2015. And for the full year, significant reduction from BRL149 million to BRL55 million for the year 2016. And here I'd like to remind you that we have a remaining exposure to GSF limited at 12% of the Company's hydro capacity.

Now we would like to highlight the volatility of the spot market. You can see this comparison here. As with these three comparisons if we take the Third Quarter of 2016, the lower value of BRL116 with the comparison of the current value of about BRL220. So this is a significant variation over time here.

On the upper right, we see the evolution of our installed capacity, 4%, because of the startup of the wind farms that we have already mentioned. On the lower part of the chart, we show the levels of our reservoirs, be it of the interconnected system on the left and the Northeast on the right. This shows there is not a lack or shortage, we do not see any immediate risk in the short run. But some risk regarding the prices because of the possible startup of thermal power plants in the future due to the lower level of reservoirs in a comparison. With the historical levels of the previous years on the left, we see a forecast for the estimate to close at 40% of the interconnected business, NIPS 70% of the historical level, that is to say this figure is very much lower than the average. And on the right, the same information for the Northeast reservoir levels to (inaudible) 21% of reservoirs, much lower than the historical level.

Now I would like to give the floor to Gustavo Estrella, our CFO. And he will be talking about the financials of the quarter.

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

Now let's start with Slide number 9. We see the results of the Fourth Quarter of 2016. Here we show the IFRS results net of the results of RGE Sul in order to make it easier for you to compare the results on the same base. IFRS, we see net revenue, 11.8% increase, EBITDA a drop 12.6% or BRL145 million. And the variation of minus 62% in net income, or BRL225 million, through 2015. And when we break down the effect starting with the EBITDA in the distribution segment, we see a variation of BRL117 million negative. And I would like to mention that the major effect on this drop of our EBITDA in distribution comes from the posting of the financial assets of the concession show in 2016. We reclassified the posting of the remuneration of the financial assets, which was in line of financial results and now it impacts our operating results, that is to say our EBITDA, a

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variation of BRL160 million and basically this is the effect of inflation. And here we saw a drop in inflation vis-a-vis 2015, a major one I would say, practically half of the inflation rate of 2015. And of course we have a lower effect on our revenues. And we would like to remind you that this is a non-cash effect. So these are the assets that will be remunerated after the end of the concession. That is to say they do generate results. However, they do not have a short-term cash effect. Because of that, the result of the distribution business will be impacted positively over BRL40 million and the main effects are also the OpEx with the variation of inflation. But still impacted by the collection actions that have been carried out, not only ADA with the increase in delinquency rate or stabilization of delinquency at high levels, as Andre said. But also the actions that we have been putting in place regarding collections in order to fight the delinquency. And one highlight is the maintenance at high levels in our number of disconnections. And of course, we have the positive effect, which is a contribution of the RGE Sul in basically the month of November and December 2016 brings a positive impact on our overall result of BRL36 million. A positive variation in the quarter of BRL34 million of legal and judicial expenses, nonrecurring items of 2015 that did not occur in 2016. So in a comparison, you have the positive effect of BRL34 million. It's also the exchange rate of Itaipu, the variation positive in this quarter. And I would like to remind you that the same effect also happened in the financial results.

Now let's talk about renewable generation, BRL103 million, two effects on our results. So the first one is a whole series of write-offs that we carried out in the Fourth Quarter of 2017, BRL75 million written off had also non-cash effect. The write-off of assets and also the write-off of provisions for goodwill because of the merger of our assets. But no cash effect for this Company. And also some effects that are also nonrecurring in 2015 that were positive and that do not happen in 2016. And that has an impact on the results of this quarter. Net of these effects, what remains is a positive effect because of the contract and the pass-through of inflation and long-term contracts and also the startup of new projects over the second half of 2016.

So talking about EBITDA and commercialization, here we see a nonrecurring effect of 2015 also an impairment of assets in our businesses. And this impairment happened this year with an impact of BRL31 million on a comparative basis on conventional generation. Basically, this is the effect of the transfer of inflation rate to our generation contracts. They are all long-term contracts. They are indexed to inflation indices, be it the IGPM or the CCA. And BRL29 million of positive effect of this variation.

When we talk about the net income beyond the EBITDA, the variation of the financial results of minus BRL125 million because of net charges plus our mark-to-market, a negative variation of BRL87 million basically due to the increase in our indebtedness. We see a major acquisition here at the end of last year. And also because interest rates went up basically 1% vis-a-vis 2015. Besides, we start to post and integrate the financial results of RGE Sul and made this Company. We have a gross debt of (BRL1 billion) and BRL100 million and we carry over a financial expense to our consolidated results. And in this quarter, it was BRL33 million. Besides, there is the exchange rate variation of Itaipu, a positive effect on the EBITDA. And that has this change here in the financial results.

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On the next page, the results for the full year, we follow the same method of presentation. We show the effect of the IFRS and also IFRS minus RGE Sul. On a comparative basis, without RGE Sul, 9.8%, BRL2 billion drop, already reflecting the drop in the tariffs over 2016 and bring about a reduction in the (inaudible) EBITDA, a drop of 1.3%, BRL53 million. And an increase of BRL31 million in our net income.

So breaking down the EBITDA per business, we see a drop in distribution to BRL199 million. And the important thing here is to highlight for -- exclude the financial assets of BRL212 million. And also the Itaipu variation, that we have a positive result in distribution because of that. And we have the effect of the transfer of prices over 2016. Basically this is the reflex of a tariff increase over the Parcel B, which is basically the center of the inflation rate over 2016, close to 10%. That is a major effect of (inaudible) inflation and what we see as the variation of market and price with BRL210 million. On the previous slide, we saw the market variation which was very small. And when we look at the low voltage or residential sector, only 0.7% drop. And with the maintenance of the contract for demand in industrial consumption, we see an impact of market variation, which has an impact on the results of 2016. So this has to do with the pass-through of prices of our tariffs over the year, also an important variation of 9% on our OpEx.

The effect of inflation happens not only in revenues but also in expenses. Many contracts in which we have the transfer also of the inflation rate to our contract and a major effect on our OpEx. I would like to remind you that, beyond this transfer of inflation, we have increased because of collection actions and we maintain and intensify our collection actions in order to fight delinquency and also the increase in our ADA over 2016.

Now, talking about renewal generation, most of it comes from the provision for losses. And this does not affect the cash flow of the Company. So we have just an accounting effect here, the effect of indemnifications that are provided for in a contract BRL57 million. And also intra-group contract that we will see the same effect on the commercialization part. And over 2016, we saw also the impact of increase in wind operations with recovery of the wind rate vis-a-vis 2015.

And I would like to mention here also an important impact of GSF over the year. GSF also contributed BRL56 million to the results of our renewable generation business on a comparison with the previous year conventional generation, we have the effect of GSF and we have a much more stable business here. Basically the main effect here beyond GSF with BRL38 million is the price adjustment of contracts with an increase of BRL163 million to our contracts.

In commercialization, as I said before, the main effect here is from the contract with CPFL Renovaveis with a positive effect of BRL57 million. Besides, we also see an increase in our business of services over the year, which also contributes to the positive results for the full year.

Let's talk about the net income financial results, a total variation of BRL46 million. And what we have here besides the effect of Itaipu, which was negative on the EBITDA and positive in the financial results, we see a variation here of debt charges of BRL232 million,

basically increasing our indebtedness, basically because of the increase in our CapEx and also due to the acquisition that we closed at the end of last year and also the increase in the interest rate of about 1% vis-a-vis 2015.

Slide number 11, this is the most important part of our results. It is a reduction of our indebtedness. So we show our indebtedness here, closing the year with 3.21 net debt EBITDA ratio. This is a very important number for the Company. It shows a slight recovery in our results and also increase in investments in CPFL Renovaveis and already considering the investment that we made in RGE Sul. So a positive expectation for the evolution of our level of indebtedness from 2016 to the future.

When we look at our interest rate, (inaudible) more or less stable over the second half of last year, which means that we have a certain stability in the average gross cost of our debt, closing the year with 13.7%. And when we look at the real one, of course it goes up because of the drop in inflation over 2016. It is important to say that our debt is very much indexed to the CDI. And with the perspective of drop in interest rates, for each percentage point of drop in interest rates, we see a drop in our financial expenses between BRL80 million and BRL90 million. So with this outlook for a drop in interest rates, we have a positive outlook for financial results for the Company over 2017.

On Slide number 12, an important point is the following liquidity. So we have a cash balance at the end of 2016 of almost BRL6 billion, more than enough to cover all the maturities, short-term maturities, of the Company. And in fact, the Company is already working to roll out debt looking at the maturities of 2018. But we see major concentration in 2018 and 2019. So we have already started to work to roll out these debts and we expect to have 2018 already being dealt with in 2017.

On Slide number 13, two major projects for the Company, which are the Campo dos Ventos and Sao Benedito wind farms that were delivered totally at the end of 2016. And they started operation in fact as of the beginning of the second half of 2016 in fact. So they were major projects and they were delivered at the end of last year. They brought about an increase in EBITDA in 2016 close to BRL15 million and, for 2017, the real increase of EBITDA for the Company will be around BRL150 million, which means that it's very important 231 megawatts of installed capacity and they will start to generate revenues for the Group as of 2017.

Two other major projects already also in CPFL Renovaveis on Slide 14 the Pedra Cheirosa wind farm, commercial startup 2018, 48 megawatts of installed capacity. And also the Boa Vista SHPP expecting to start up in 2020 with 26 average capacity. And these are two projects that we started already to execute. And there's no difference regarding the schedule that we had on our business end and financing shown under analysis by the BNDES.

And lastly, on Slide 15, we talk about our transaction with State Grid and after the change of control on January 23, now we start to work on the tender offer operation. So we submitted a request on February 22 for the unified tender offer, which is mandatory. And also the delisting tender offer and the class change tender offer. So we are with



interactions with the CBM in order to register the tender offer so that we may execute it this year. And we have no expectation yet regarding the timeframe for the conclusion of this operation. It depends on many factors. The interaction with the CBM is one of them. But this is a process that is already underway since February 22.

Now I would like to give the floor to Andre.

**Andre Dorf** {BIO 15460232 <GO>}

Now, in fact, we are going to give the floor to the moderator to start our Q&A session.

## Questions And Answers

### Operator

Ladies and gentlemen we will start the Q&A session. (Operator Instructions)

The question-and-answer session is closed. We would like to give the floor back to Mr. Andre Dorf for his closing remarks.

**A - Andre Dorf** {BIO 15460232 <GO>}

Very well. As we were able to see during this presentation, this was a very intense year for CPFL, quite a lot happening. We had a succession in the CEO of the Company and many measures to tackle delinquency and the acquisition of RGE Sul, the delivery of important projects by CPFL Renovaveis. And a more structural change, which was the change in control of CPFL with the acquisition by State Grid, acquisition of the stake of the former controlling shareholders. And of that, we were able to continue with our operation in a very smooth fashion, with a very serene fashion, as you can see in our results. And with that, the Company starts a new cycle now in 2017. And we are very enthusiastic and full of energy in order to face the future and tap into the opportunities of our market. On behalf of the executive committee, we would like to thank you for your confidence and we expect to continue to deserve your confidence in the future. Thank you very much.

### Operator

CPFL Energia's conference call is closed. We thank you for participating and wish you all a very good afternoon. Thank you.

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