

Q2 2018 Earnings Call

Company Participants

- Andre Dorf, Chief Executive Officer
- Gustavo Estrella, Chief Financial and Investor Relations Officer
- Luis Henrique Ferreira Pinto, Chief Regulated Operations Officer

Other Participants

- Bruno Varella, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and thank you for waiting. Welcome to CPFL Energia's Second Quarter 2018 Earnings Conference Call. Today with us, we have Mr. Andre Dorf, CEO of CPFL Energia; Gustavo Estrella, CFO and Investor Relations of CPFL Energia and other officers of the company.

The presentation will be available for download at the Investor Relations website at cpfl.com.br/ir. We would like to inform that all participants will be in listen-only mode during the company's presentation. Afterwards, there will be a question and answer session when further instructions will be given. (Operator Instruction) I would like to remind you that this call is being recorded.

Before proceeding, we would like to 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 on information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, certainties 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 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, we would like to turn the conference over to Mr. Andre Dorf. Mr. Dorf, you may proceed.

Andre Dorf {BIO 15460232 <GO>}

Thank you, and good morning, everybody. Welcome to another CPFL Energia conference call about our results, and this time about the second quarter of 2018. As usual, we have a brief presentation and then, we will be opening for questions.

Slide three please. This is where we have the highlights of the quarter. The load measured in our concession area grew by 3.8% in the period. And later on, we will be seeing that most of this growth, as we have been saying over the last few quarters, happened in the free market, growing about 7%. Also, we had growth of 16.5% of our net operating revenue and we will also see that this comes basically from the distribution segment and 33% EBITDA.

Our net debt, measured by our covenants, closed the quarter at BRL15.7 billion. Therefore, our leverage was 3.11 times -- our net debt-EBITDA ratio over the last 12 months. We also had an important amount of funding, 3.4 billion in this quarter owing to competitive rate. In the quarter, we invested BRL422 million in all segments where we operate. Also in the second quarter, we concluded the RGE tariff review with an average effect perceived by consumers of about 21%.

Regarding growth, CPFL Geracao won Lot number 9 of the transmission auction that we had in June. So we won the Maracanaú lot in Ceara, with a CapEx projected by ANEEL of about BRL100 million. And over the quarter, we also had some other relevant sectoral issues. It is important for us to see that flags or tariff lags, via-a-vis regulatory assets is a very important theme and you know that we accumulate regulatory assets and some of them have to do with GSF and thermal startups and hydro situation, the variation that comes from Itaipu and they should be covered by tariff flags, which has not been happening, means that we have been accumulating regulatory assets that are important over these months.

And then, another that is being discussed by us with the GSF with the short-term settlement of CCEE and part of the solution is also part of the Bill of Law that is inserted by Congress and that has to do with privatization of the Eletrobras distributor companies, and this is being extensively discussed or was extensively discussed during the quarter.

On the next slide, slide number four, we see our EBITDA per segment. In the second quarter of '18, we had an EBITDA of BRL1,270 million. And on the upper chart on the left, you can see the breakdown per segment of business. So our distribution represented almost 60% of the EBITDA, followed by conventional generation and renewables as well with 24% and 17%, respectively, and the other businesses still represent a very small part of the period EBITDA.

And looking per business segment and starting on the upper right of the chart, we see the evolution of the EBITDA in the quarter and in the half year. So a major evolution of the EBITDA in distribution, as you can see, BRL768 million in the second quarter of '18, almost 70% increase vis-a-vis the same period last year and very much because of the growth of the market itself and also the control of PMSO and the financial assets of the concession. So, these are the two main positive impacts on the EBITDA of the distribution segment.

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Conventional generation, a slight reduction, very much due to the reduction of the assured energy of Serra da Mesa or SEMESA plant. In renewable generation we had a major growth of almost 15%. And here, there were many impacts that are described in our release and Pedra Cheirosa wind farm is one of them. And then commercialization services and other segments where we operate, the highlights here is our services segment in construction and grid maintenance that had a positive contribution to this increase.

On the next slide, we talk about the distribution segment. (Technical Difficulty) of the increase is load and then sales in the period, and they were very much hand in hand, about 4% each. And the major growth also in residential and commercial, 5.7% and 3.7%, respectively, and here mainly because of the high temperatures in April and May.

In industrial segment, although we had the truckers strike and also the economic scenario of the country in spite of rollback, we achieved a growth of 2.4% in this period. And the highlight in the class -- in the industrial class are the metallurgic industry and vehicles and food industries that had a positive impact on this growth.

If you look at the upper right, we see the sales in the concession area, as I said, growing 4% and very much impacted -- positively impacted by the customers in the free market, 7.6% increase. On the lower part, starting at the left, we see the market breakdown in the concession area and consumer class, our biggest one in this is industrial with almost 40%, followed here by residential and commercial.

And we're we compare our growth in this area and in the regions where we operate we see a positive evolution as well. For instance, in the first map in the middle chart or the lower part of the slide we see that Brazil 2% on sales and CPFL grew 4%. In the Southeast region, we had a growth of 3.2% and we grew 4.1%. And in the South of Brazil, the region 4.2% increase and we 3.8%. On the right, we can see the evolution per consumption segment and these figures have already been mentioned when we talked about the highlights on page number six.

Now, we talk about delinquency. Unfortunately, this is a very much fashionable thing, so to say. Our ADA evolution as a percentage of the gross revenue is at the same level in this quarter, 0.64% of the gross revenue in provisions, which is very much in line with our historical average. And I would like to mention one point outside the curve, which is in the first quarter of this year and this was very much because of a reversal, a non-recurring reversal in our ADA that we had in RGE Sul in the first quarter and that was not repeated and will not repeat -- be repeated from now on. So, we are in line with our historical averages.

On the lower part of the slide, we see the total of past due bills -- over 90 days past due as a percentage of the gross revenue, and very comfortable 1.15%, and our collection actions on the right -- on the lower right in thousands of disconnection per quarter. And we see in this chart, a reduction in the number of disconnections. However, this is not a strategy of the company, it's not the change in behavior, but it was caused by the truckers

strike that we had in May. So we should go back to the previous figures that we had in previous quarters.

And some news here on page number seven. Here we included a snapshot of our operating indicators during the period and also the comparison with the previous periods. In the first chart on the upper part, we have total losses -- technical and commercial losses. And here what we can see is a trajectory or downward trend in our total losses compared to previous periods, and technical loss as well going down and commercial or non-technical losses also dropping, but a little bit more resilient because of the crisis and because of the economic scenario where we find ourselves.

And on the bullet points on the right, we made a list of some initiatives that the company has been putting in place in order to fight for the losses. And so here we are talking about new technologies to combat the theft of energy and the expansion of telemetry client network, improvement, modernization and shielding of the distribution network, replacement of measuring equipment, modernization of our hubs and update of public lighting points, and the inspection of new expansions and update in our client file -- our customer file. So, these are some of the measures that we have been adopting to fight losses and theft.

On the lower part, we see the evolution of the SAIDI and well below the better [ph] in the center the two figures. We see here in the middle an evolution of our -- in our distribution companies, a positive evolution, that is to say, a evolution of our SAIDI. And also our SAIFI also going down. We see a positive evolution in all our (inaudible).

And here, we made it drill. Well we've calculated the weighted average of the SAIDI and the average weight by the number of customers and we got to 8.74 hours of interruptions. And this is equivalent to an availability equivalent in the service area to 99.9%. So on an average we had an availability of 99.9% availability in our services.

As these charts on this slide also have the objective of showing that although (Technical Difficulty) this did not happen to the detriment of quality of service or investment. The company continued to invest and continues to invest. The company continues to improve and to bring on board technology in order to deliver more quality and better indicators to our customers.

On the next slide, we talk about generation. Our generation segment show on the upper part, we have the reservoir levels and that became a point of concern during the last few months because of the very dry weather that we had. And on the left, we show the Southeast -- the lake's reservoir levels, which closed last month or that is now on August 16th, at 34% of the level compared to a historical level of 54. And Southeast which is very important, we have 31.6% on August 16th in comparison to 54% of our historical level.

Now, to the left bottom chart, we have the performance of our spot price with volatility. If you look at it, in the last two years, but now it's at the ceiling of 500 and something miles per megawatt hour. And to right bottom chart, we have the GSF projection and the market is talking about a GSF -- very recent now of 39%, but the GSF is measured

depending on different factors. So you can see here, these factors, 07, 06, in June and July, respectively, and a trajectory of GSF that is negative or that is -- a factor that is below 1 for a long period of time over this year. Therefore, we did have in July, 39% below in generation -- that is 39% below of our assured energy.

Now I end my presentation and I will turn the floor to Mr Gustavo Estrella, our CFO, and he's going to talk about the financial result.

Gustavo Estrella {BIO 18109709 <GO>}

We have here the results of the company in the second quarter. These are positive results (Technical Difficulty) 33.3% and a net income 265.5%. And as Andre said before, the main highlights here comes from distribution. We see here a total positive variation in the segment of BRL315 million coming mainly from the market and tariffs.

Once again, we have a growth in energy consumption. We said here that there is an increase in temperatures bringing therefore greater consumption in residential areas, but also we have the tariff review process that we had at CPFL Paulista and RGE Sul, also with a positive impact, in these results from the MTM.

We -- also, we had a positive effect from the concession financial asset with BRL106 million. Basically, the two main effects here, first, the adjustment of the inflation by the IPCA and the second effect here is the productivity indicators that also brought a positive effect to our results and that's how we get to the BRL106 million. We also have the results of private pension funds of positive BRL6 million. And as Andre has mentioned, a variation of our PMSO of BRL36 million positive. We had less expensive vis-a-vis 2017 and the main highlight here is coming from legal and judicial expenses, which were provided us BRL26 million.

In conventional generation, we have a negative total variation of 9 million. There we have an agreement regarding GSF and lower exposure that we have to GSF, and that was rather stable when -- also because of the inflation. Here, specifically we will have the effect of the reduction on SEMESA's assured energy by 5%, which represented minus BRL7 million.

And commercialization plus 3 million and renewable generation, we had a total positive variation of BRL33 million. In this quarter we had lower wind farms generation because of lower wind speeds, with a negative effect of BRL14 million. But that was more than offset the by other effects. And the first one is a credit recovery of PIS and Cofins adding up BRL18 million, also the participation of the MCSD, allowing us a positive effect of BRL13 million in our results and the start-up of Pedra Cheirosa wind farm complex also bringing BRL8 million to the quarter.

Now turning to the net income. We do have here the reduction of the interest rates, which allowed us to have a reduction in our financial expenses of BRL123 million and also a positive effect of mark-to-market with BRL58 million.

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Now turning to slide number 10. We have our indebtedness and the main highlight here is the reduction of our leverage. Now we are at 3.11 times net debt-EBITDA ratio at the end of first quarter and the main highlight here probably is the robust growth of our adjusted EBITDA for the last 12 months, over BRL5 billion. And remember that and despite of that lower leverage, we still have here, as Andre mentioned, some regulatory assets and that makes us carrying to our debt BRL1.1 billion of regulatory assets that we have to transfer that to tariffs adjustment next year.

Now in terms of that profile we have a costs of 7.6%, stable vis-a-vis a prior quarter, but we are faced to the scenario of interest rates going down in Brazil. Regarding our index, half of our debt today is prefixed so these were that's -- that initially were indexed in the CBI now they are prefixed and so these are our main indicators and we have very low volatility for the year.

On slide number 11, we have our debt profile and the amortization schedule. You can see that for 2018, the company since the beginning of the year 100% refinanced and we are working already with refinancing already for the second half of 2019. We are doing that, as Andre mentioned in the beginning of the presentation, in the second half of the year we have funded 3.4 million, and this was basically to refinance existing debt, so we are extending these that's and also we are having lower rates there. Therefore in August we will be almost BRL1 billion more just exchanging that debt profile in the short time.

Now on slide -- and on the next slide I should highlight the conclusion of the tariff review process of RGE now in June. And the main highlights here is the growth of the regulatory EBITDA. We see that there is a leap of 103%, we reached the BRL543 million in this fourth cycle and this is very relevant and it starts to affect basically starting now in the third quarter of '18.

And another important highlight is the participation of the company in the transmission auction that happened (Technical Difficulty) end of June. We now won the Lot number 9 of Maracanaú in the State of Ceará and we estimate an investment of BRL102.2 million. So this is our third transmission project that will have here in the company. We have already have concluded two and this is a new line that is in the construction process.

So now we to turn the floor to the operator to start the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now start the Q&A session. (Operator Instructions) Our first question is from Bruno Varella, Solana Capital.

Q - Unidentified Participant

Hello. Dorf and Estrella, good morning. I have few quick questions, the first one is about consumption now in the third quarter. I would like to understand is that at the same level

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of the second order growing at 4%? My second question debt leverage of 3.1 times. Do you believe this is feasible considering a stronger EBITDA after the review and a leverage for the next -- for the end of the year around 2.5 times? Would it make sense to think along those lines?

And third question, the transmission process that you were awarded in Ceara, we have the discount of 54%. I have a return rate that is very low. I would like to understand what would be an optimized CapEx on your side? And is that possible to tell us more about the, IRR that you foresee for the project? And finally, about passive privatization, what is your idea, do you expect to have a complex M&A because of the amount of contingencies -- but what about after the agreement with the prosecutor's office that the company has made it, that has changed to be or understanding about the privatization?

A - Andre Dorf {BIO 15460232 <GO>}

Good morning. Bruno this is Andre and I will start by the last two questions and then I will turn to Gustavo to talk about leverage and the market growth. About the project in Ceara, yes, we do have a streamlined CapEx, more than the one estimated by ANEEL. We don't disclose our internal (Technical Difficulty) our financial discipline and a complex discipline of the company. So we not letting go the internal return rate, very much on the contrary, we have an attractive project considering the CapEx estimate that we have.

Yes, we are assessing all possibilities of growth that we have here in our segment and I'm talking about that and for us that is under the radar. I don't know if today, we would have alternatives to grow that would be closer to what we expect to have in our businesses. So we're assessing it but we do have other possibilities that are more encouraging.

Now Gustavo turning to you.

A - Gustavo Estrella {BIO 18109709 <GO>}

Bruno, talking about the consumption in the third quarter, the expectation that this recovery will remain in this quarter it started basically in the second half of last year. We expect to keep the same phase, but when we compare a percentage of growth considering that we have a consumption pace that is already a higher last year, we are start having a percentage growth that is a little bit lower so we believe that this will be closer to 3% now to this third quarter. But that recovery signs are still there.

Now, the second question about leverage, we are clearly at a downward trend for our leverage and the new factor that we have here is that regulatory assets that could affect our short term leverage. Today, we have a volume of assets of 1. (Technical Difficulty) that is growing a lot by the of the year. So we're not reached 2.5 of leverage, I would say that basically because of this high regulatory asset, but when we start transferring that to tariffs over 2019, we will have a drop in leverage that will be even more significant. We are not going to get to 2.5 right now, but without that regulatory asset, we would get there. Thank you very much

Operator

Our next question is from Fabian Ross [ph] , Absolute Investment .

Q - Unidentified Participant

Thank you very much. My question has already been answered.

Operator

(Operator Instructions) Bruno Varella, Solana Capital.

Q - Bruno Varella

Thank you very much for the additional question. I have doubt about losses. I understand that, of course, the overall economy impacts commercial losses, of course, but there is a specific point in RGE Sul, looking at these technical losses in the last 12 months, we see an increase in the last 12 months of about 40 bps vis-a-vis the second quarter of '17 and then you have a drop of non-technical from the third quarter and then, going up again in the second quarter.

So I would like to know what specifically affects the technical losses in RGE Sul, going up consistently in the last few quarters? And what about the environment regarding the non-technical losses? Do you see anything different, in the environment different from the other concession areas and mainly in RGE because the technical losses are very low in RGE, so could you please talk about the environment in which Sul operate RGE Sul operates?

A - Luis Henrique Ferreira Pinto {BIO 19709527 <GO>}

Bruno, good morning. This is Luis Henrique. Regarding the non-technical losses of RGE Sul, ever since we acquired the company, we have been doing work in terms of the calculation of losses . We have been improving it or streamlining it because the difference is in calculations in the technical losses and with the difference you have the non-technical losses. So these calculations we have been streamlining them every single month ever since we acquired the company and better understanding and installing the necessary and adequate measurement instruments so that we have the most precise calculation possible. So we did this calculation and we're streamlining it and cleaning it up so to say and this is the reason why there was an increase in technical losses because we were streamlining this calculation and that reduces the non-technical losses, of course.

And in this quarter, in RGE Sul you have seasonality and this is something very critical. You have the hydro -- in the South, where you have a lot of rice cultivation, or plantations, and this causes an upside difference that we monitoring and other consumption characteristics of the company, that we are assessing and that being about the seasonality of work are we doing about it. So, having a good calculation of the technical losses.

Secondly, we're investing a lot in the grid and the flexibility of the grid itself and this is translated into reduction of technical losses. However, this is not seen in the short run, it will take some time, until we see those. And about the others, we are having a project to install such as we did in the Sao Paulo companies, we're going to shield and invest in

telemeasury and everything will be telemeasured and with that, we're going to monitor the consumption of these customers. And with that we will be able to visualize and therefore, we will be able to make measures in the group A and which is very important in certain periods of the year.

And for this reason we are also getting know and getting to streamline these calculations, but the plan is already set out for the next few months.

Q - Bruno Varella

Thank you very much Luis Henrique.

Operator

(Operator Instructions) We end now the Q&A session. I would like to turn the floor back to Mr. Andre Dorf for his final remarks.

A - Andre Dorf {BIO 15460232 <GO>}

Very well, over the second quarter of '18 we have completed two years since we started the transition in the stake holding of the company. So you have been able to see that over this year -- this time our team was able to focus on operations, to improve the -- team also in our operations team and also we were able to focus in the capital discipline.

Everything that we have discussed today in the results of the first half of the year as a whole do show our efforts and also our commitment to the results in the short term as well as with the sustainability and the results in the long term as well. So I now end the presentation and the discussions about the results for the second quarter. Once again, thank you all being with us and thank you also for your support. Thank you.

Operator

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

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