

Q2 2021 Earnings Call

Company Participants

- Gustavo Estrella, Chief Executive Officer
- Unidentified Speaker
- Yuehui Pan, Chief Financial Executive Officer and Investors Relations Officer

Other Participants

- Analyst
- Marcelo Sa

Presentation

Operator

(Foreign Language)

Gustavo Estrella {BIO 18109709 <GO>}

(Foreign Language) -- (Multiple Speakers) -- complementary dividends. At the same time, we also do an important movement of the growth of the group with the acquisition of another company. As we always say, the strategy of the group is always to balance the growth with the yield. So I think we're doing these two things at the same time in a combined way and in a responsible way. This makes the strategy of the group very balanced. In this -- besides CEEE-Transmission, we have Gameleira Complex and we also have Costa das Dunas, Figueira Branca, the last park will start to the end of the year. We also highlight the operation, 2.5 years before the official date of ANEEL. We also have an ESG agenda.

We have the index of the stock exchange of London, giving the help that we have focused on the ESG topics. We've also had in this ESG agenda. We were recognized by the World Finance Corporate Governance Awards for 2021. This is a very important recognition for governance linked to the (inaudible) only company in Brazil recognized this way. So, it's very important for our group. And last, we have the CPFL Santa Cruz, which has won for the second time the ANEEL Quality Award in the category from three 30,000 to 400,000 clients. This is also very important in the quality topic of our group.

Now, let's move to the next slide. So, here we can see the energy sales, as I said, it's a robust growth of 12.19%, 3.7% in the concession area. We've put the comparison here with 2019 and 2020, that was the beginning of the pandemic when we had a worse moment of energy consumption. And in the second semester, we already had a recovery. And in

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the comparison to 2019, we can see the growth. So the -- I think this is a signal, a clear signal of robust recovery in relation to the energy consumption.

And the good news here is that this has been especially due to the industries, so this shows an important recovery of the economy. I think it will be over 5%. So this recovery of the industry is very important, as we can see in the second quarter 27% very expressive and very positive. I think it has the power of really energizing the economy in a very positive way. Here, we can see within the industrial activities, we can see all the main segments within industrial class. So we had important growth, we've put here in order of importance and in order of size, how much it represents of the CPFL Group. It is led here by the segment of food, which corresponds to almost 18% of our total industrial consumption growth already in the comparison to 2019, 5%. The exception is vehicles they had a important recovery, but still a bit below 2019, but it also shows a very robust recovery in the segment of vehicles.

So, let's move now to the next slide. Here, we can see the delinquency and the losses. The second semester confirms a trend that we've already noticed since March this year. We have this in results called is a trend of an increase of delinquency, it confirms here we can see a large growth compared to the first semester of 2021 and almost stable in relation to the second semester of 2020. But this is a concern we have intensified all our actions to mitigate delinquents in increasing the cuts. We have here 665,000 energy cuts. This semester, it is a large number, it's 30,000 energy cuts per month. And this is to try to control this level of delinquency which for sure concerns us now.

When we look at the right side of the slide, we can see the benchmark and this is a trend not only for CPFL. But in the sector in general. We can see a clear trend of the increase of delinquency with other distributors. So we have had a lot of challenges. We're still in an update -- of the economy. We have clients, especially those with lower revenue. They're still suffering a lot. So informal jobs, we know that this recovery has been a bit slower than the economy in general. So this has reflected in our results. So this is a point to pay attention and to monitor the next month. It's not only losses we have here an almost stability in relation to June. So it's been recurring. We have stability in the rate of losses and we have a huge effort here to monitor and to stabilize these indicators.

So, let's move now to the next slide. This is refers to generation. We can see an increase of the PLD, this increase is even larger. We see this is 583 megabytes hour, and this is very much linked -- of our country, and we also should pay attention, and this should remain high for the next month. The GSF has an improvement if you compared to 2020, but the GSF here in the second semester of this year in high levels.

As for the flow, we have an almost stability a little bit higher. To remember in the South of the country, it is still is a bad hydrology, but in the past, it was extremely negative. So this stability here is very much related to the base of comparison with 2020. But this reflects the lack of rains that we've been having in relation to the SP -- SHPs. There's a concentration here in the state of Minas Gerais and the state of Sao Paulo. So this is always reflects a reflex of the hydrology when we compared to 2020.

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And now let's talk about the wind parks -- wind farms. We've had expressive of growth and megawatts per hour, and this reflects the improvement of the performance of winds. We had a very negative performance in the past. With levels much closer to the curves and this reflects in an increase of generation and especially considering the availability of the wind farms. We can see historic of recovery, which is very important, especially I think we have a very good level here 96% and with favorable winds, we have much better generation of energy.

So, now let's move to the next slide, this has to do with the result. So now I'm going to give the floor to Mr.Pan.

Yuehui Pan {BIO 20609514 <GO>}

(Foreign Language) Good morning to everyone. Thank you, Gustavo. In this slide, in this slide, in this quarter was a bit higher than BRL2 billion, an increase of 70%. The segment of distribution has a good results, again with an increase of over a 100%. The largest variation was in the markets in tariffs BRL407 million, especially due to the increases of tariff that we had and the readjustments in 2020 and 2021. Another important effect was the gain of the concession finance asset that had an increase of BRL283 million due to the higher IPCA.

In the second quarter of 2020, the IPCA was negative 0.62%, and in the second quarter this year was positive over 2%. We also had a gain of BRL21 million referring to other revenues. Here basically it's the rental of posts [ph] that reflects the increase of the IGP-M during the period. The PMSO had an increase of BRL54 million due to an increase in assets legal expenses and low base of comparison last year. The expenses linked to inflation had an increase of 5.4% below the IPCA, which was 8.35% during the last 12 months. The PDD was the largest BRL21 million as -- or the highest as we've shown previously. In the pension plan, we had an increase of BRL14 million.

The other effects of EBITDA all added were BRL3 million. In generation, the EBITDA was BRL728 million, an increase of 37.3%. The main effect was the update of the contract prices BRL134 million, several contracts that are updated by the IGP-M had the prices adjusted during the other months. Another positive effect was the higher generation of energy of our wind farms with the BRL52 million and the seasonality of the PCH contracts BRL39 million. On the other hand, we had some negative impacts during the period, an increase of the UBP due to the high IGP-M BRL18 million, GSF minus BRL5 million other effects minus BRL3 million.

The segment of trading, services and others had an increase of BRL21 million. Trading improved the results and BRL15 million due to the recognition of (inaudible) things over the ICMS in CPFL. In the service segment, another BRL5 million. CPFL efficiency is a highlight once more. On the other hand, we had a reduction of BRL30 million in trading due to a lower margin during the period.

Now, on the next slide, we are going to show the performance of the net earnings, which was BRL1.125 million during the period, an increase of 143.6% in relation to last year. In the

financial results, we had an improvement of BRL63 million due to the increases and fines BRL63 million. This was due to the high IGP-M gain of MTM BRL41 million and recognition of the monetary update of the PIS/Cofins over the ICMS in CPFL of BRL40 million and the expenses with a net debt have an increase of BRL84 million. This is explained by the increase of the IPCA. The depreciation varied BRL2 million and taxes had a negative impact of BRL246 million due to the better result during the period.

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The next slide we show the results of the first quarter, the EBITDA grew 38.4% or over BRL1 billion. Here, we can highlight the distribution that has increased 42% favored by the good performance of the market and tariffs due to this -- the growth of the IGP-M and financial assets. Another highlight is generation with an increase of 28%, BRL302 million due to more wind generation and readjustment of contracts. Now, the commercialization segment had a gain of PIS/Cofins over ICMS, while the service segment has been improving its results, especially CPFL efficiency.

The net earnings have increased 52% reaching almost BRL2.1 million -- billion. This result was a bit impacted by the negative MTM BRL249 million, which registered a strong gain in the beginning of 2020 and this affected the comparison base. Besides this, we have a higher cost of the debt pressured by IPCA. These effects have been partially compensated by increases and moratory fines. We have a positive effect of BRL5 million in depreciation and amortization and larger taxes due to better operational results.

Now, let's move to the next slide. The net debt totals BRL15.7 billion and EBITDA has reached BRL8.3 billion. The leverage measured by the net debt EBITDA is 1.88 times. In relation to dividends after the acquisition of the CEEE-T, we're bringing excellent news. Besides the payment that was carried out in June, we now have the declaration of the 50% which was left, resulting -- results of 2020, totalizing a payout of 100%. The dividends worth BRL1.7 billion equivalent to RBRL1.50 per share will be paid up to the end of 2021. We are trying to pay the earliest possible.

On the charts on the lower side, on the left, we have the cost, growth debt cost nominal and real. This is due to the variation of the IPCA during the period. But the real cost is negative. Now in the composition of the gross debt, we can see that the highest exposure is indexed to the CDI with 73%, but we also have 24% of debt linked to the IPCA and this effects a bit more the financial expense in the recent period. At the end of the second quarter of 2021, we had cash flow about BRL2.7 billion with a coverage rate of 0.59 times the short-term amortizations, the medium-term of amortization is 3.16 years.

Now, let's move to Slide 13. Here, we have the CapEx and we've had an acquisition of more than BRL1 billion, an increase of 57% compared to the same period last year. In the vision per segment we had, in distribution, a total of BRL738 million into the increase in modernization and maintenance of the -- and maintenance. For generation and transmission, BRL224 million to continue the projects of Gameleira, Cherobim and the recovery plan, maintenance of parks and BRL36 million for the transmission projects, Maracanau, Sul I and Sul II.

For the segment of trading and services, we destined BRL22 million CapEx of the semester. We did an investment of BRL1.7 million, an increase of 48%. Per segment, distribution total invested 1.3. Generation and transmission invested BRL340 million, and for trading and services BRL38 million.

Thank you very much. Now, I'm going to give the floor back to Gustavo Estrella.

Gustavo Estrella {BIO 18109709 <GO>}

Yeah. Thank you, Pan. (Foreign Language)

So moving on, as I had said, I think the Gameleira wind farms, very important 2.5 years before plan. We have costed as soon as Figueira Branca and Gameleira, it's about 57 megabytes of installed capacity, the total capacity. We also have Touros park which is going to be working by the end of 2021. And with this, we were able to sell this energy and the spot market, therefore improving the rates and the entry in our operation.

So, let's move now to the next slide. Here is I think that we're very happy with this acquisition that we did of the CEEE-Transmission is a very important acquisition 4.3 of all Brazilian transmission lines. This puts us in an important scale and the transmission and an area that we already know we know very well. So, I think we'll have a very important synergy of operations with our distributor. So I believe it's an asset, not only due to the strategic importance for our group in the direction of growth, but also due to the return of -- that we expect. I think this is a challenge that we have. We are preparing ourselves to have -- close of this operation until October, when you start this integration. We have a very positive expectation to be very well succeeded. As we had when we acquired AES Sul in 2016-17, so I believe the idea is that we have a similar process and we will demonstrate everything that the company can do to generate value with this asset.

Okay. Next slide, please. And last but not least, I think. I think this is agenda of ESG sustainability plan. This is a project which is very important to CPFL. It's research and development project. We have today the implementation of electrical vehicles in India -- over there 22 vehicles with 18 stations, we already implemented half and we hope that in the next months will conclude this project. It's going to be the first advanced station with a 100% of the fleet electrical. And I think this will be a pilot plan for us and we're going to test the technology, the recharging durability of the vehicles. So for us it's a extremely important project and our expectation is that in the future all the vehicles will be electrical, it won't be different without cars or fleet, and we can do this in an optimized way and do this the most we can. This is a very important project not only for the region, but for the company in general, just to remember that this project is part of our public compromise with the sustainability plan.

So, gentlemen, I think these were the main messages that we had. So now we're available for the session of Q&A. Thank you very much.

Questions And Answers

Operator

(Question And Answer)

A - Unidentified Speaker

We have a first question here from Frederico Sampaio from Franklin Templeton. Thank you for the participation. You can now ask your question. Frederico, I think you're on mute. Please unmute your mic.

Well, I'm going to move on and then after Frederico is able to ask the question, will put you in the line again. So let's call now Andrea Sampaio [ph] he's an analyst from Santander. Thank you for your participation. So please you can ask your question.

Q - Analyst

Good morning. Can you hear me?

A - Gustavo Estrella {BIO 18109709 <GO>}

Yes. We can hear you.

Q - Analyst

Good. I have two questions. The first question is about the growth strategy, so you have decided to pay the dividends that was -- from way back and I'd like to understand moving forward. What are the next steps? So you going to integrate the CDE transmission. And what's the growth plan from now on, are you going to continue growing in transmission? Are you -- is it generation, so what are you planning to do? The question that I ask is because you mentioned that the non-payment of dividends had been due to the growth strategy. Now, that you've paid the dividends, that means that there's no more growth or the idea is to do the two things at the same time?

A - Gustavo Estrella {BIO 18109709 <GO>}

Thank you, Andrea for your question. Well, our strategy has always been to balance growth with a payment of dividends and I think strategy continues in the same line, analysis is that we could pay the dividends without compromising growth opportunities. So we did this. We pay the dividends. I think, this payment is important for the strategy of the company in general. And when we look in perspective opportunity of growth, I think that one thing doesn't invalidate the other. So that's the idea.

You mentioned some examples, we continue looking at growth opportunities with financial discipline to investments that will bring us return on the investment. So first of all, the growth plan continues and we always evaluating opportunities. As for our leveraging, I think we have the capability of continuing to grow and paying dividends, that's what we intend to do.

Q - Analyst

Thank you. I just like to follow-up here in relation to this first question. Is there any specific asset that you are more interested in and that is in the market some specific sector that has got more attention? And the second question that I ended up by not asking was in relation to an update of yours in relation to the drought crisis. Do you think that the situation has worsened. Should we be more concerned than in the first result?

A - Gustavo Estrella {BIO 18109709 <GO>}

Well, I think, in general, the assets that come to the market, these are the ones that we're going to look at in the CDE generation. We're already partners in several hydraulic plants, so it's natural that we look at these assets. The -- so it is -- sorry, it's an asset for us to evaluate. So I think that several alternatives and opportunities on the table and we have to look at one by one to see what makes sense and what works. I think we have good opportunities. I think that's the good side. It's where we can in fact deal with what is most interesting to us and also what will give us a return.

As for the rationing, I think, the crisis is serious. We see that we have records of -- recurring records of low hydrology. The expectation low-term -- low --short-term, sorry, I think it is concerning. We do not have a rationing scenario as a base case. The scenario is that we have one year with no rationing, but the risk exists. We celebrate a matrix, which is clean and renewable, but it is 80% clean and renewable over 60% hydraulic if we don't have (inaudible) problems. And so look at the scenario, all the statistics that we have and the perspective of consumption versus our real generation capacity, rationing is still not on the table, but we know that this risk exists if we continue having a worsening hydrology.

One thing that is worthwhile mentioning is that we have a scenario short-term looking at October, November, December, that's when we start going into the hotter months and when we have more peaks of consumption and this will be our main risk. How do you attend to the demands in the peak? So I think that all these initiatives that the government has discussed to try to avoid or dislocate this peak. I think this is the way to go, so that we avoid any type of option. So at this moment, when the consumption is high, I think this is the way to go and we're in the right direction.

Now, when we go to 2022, what we have is a scenario, which is looks more comfortable. We have the expectation of new generation of over 10 gigs of new capacity, and this comes in during the year and it's going to help to alleviate this pressure. And also in transmission, you know that now main restriction in transmission is between the Northeast and the Southeast. Here we have new capacity in the Northeast with these wind farms and solar energy. We could have an increment in the transmission capacity in these areas of 28% in 2022. So you have more transmission, more generation and the expectation that hydrology. Hopefully, there'll be an uptick again. So I think, that '22 the scenario is a bit more comfortable up to the end of the year, we have more challenges. But one thing again, rationing is still not on the table.

Q - Analyst

Thank you, Gustavo.

Operator

Thank you Andrea for your participation. Let's move on to the next question is Marcelo Sa from Itau. Thank you for your participation. Please ask your question.

I think that Marcelo has left. So let's move to the next one. It's now Juliano from UBS. Thank you for your participation. Please ask your question.

Q - Analyst

Thank you, Cereno [ph]. Good morning, Estrella. Good morning, Mr.Pan. I have two questions. The first is talking about dividends with growth. How much do you think would be the target of net debt to EBITDA between 2.5% and 3%? What is your target? And when you talk about growth, you have the asset that you mentioned generation CEEE-T and you have partnership in three plants, right? So is your interest only in the plants where you have partnership with the CEEE-T or can you migrate to other plants? That's the first question. Estrella, the second question is still related to growth, the transmission business and remembering that your controller, you still deal in the energy. What's the relation with you and the control to dispute these assets? Are you going to be concentrated -- when -- where you already are as the same as what happened in the past? Or from now on, you're going to be competing with State Grid, Brazil holding? These are the two questions.

A - Gustavo Estrella {BIO 18109709 <GO>}

Okay. The first question, I think, we have a target. It's a reference of leverage to maximize the allocation of capital. We have -- this is about 2.5% EBITDA level. This is a healthy level of leveraging. So as we were the acquisition, we were the payment of dividends with the perspective of business growing, I believe that we can continue this balance of growth and with space and opportunity to -- for new assets. As for the CEEE-T generation, in fact, interest, bigger interest would be to acquire assets where we already have participation. You are correct, they are three (inaudible) so these are three that we already have participation. We know it very well. So the motivation for us to participate in this process for sure would be to look at these three assets.

And last but not least, in this relationship with State Grid, I think we have a dividing line, which is very clear, where we work and where they work. So looking at that niche strategy, we have a geographical location, size of assets, fit with current business. The main drivers that we have to invest in transmission, but also a division in relation to attention. So if we get the 3D transmission, the level -- average level is a lower voltage transmission, it has much more of characteristic of our interaction with the business of distribution than the transmission in high voltage and this all. So also has to do with dividing the two companies in this transmission, operation and lower tensions, which is CPFL [ph], and they are focused in transmission with higher voltages. So once more up to now, we've gone through ends situations of assets, coming onto the market, tenders and I think that it's been easy to define who is fighting [ph] for what. So that we don't have this dispute or this internal dispute between the two companies. We don't have that.

Q - Analyst

Thank you very much for your replies.

Operator

Thank you, Jill [ph]. Let's go to the next question. I'm going to return to Marcelo from Itau. Thank you for your participation. You can now ask your question. Marcelo, you are on mute.

Q - Marcelo Sa {BIO 16454581 <GO>}

So the question about the hydrological risk, the government has announced some measures to be able to incentivize the change of consumption in the peak times and also measures so that the residential consume reduces the consumption. Could you comment these measures? And do you think this will have any relevant impact on the demand? What you think of these proposed measures and to understand if there's rationing risk, if the final effect to the distributor. How would this pan out in the economical and financial balance? You would have the reduction of the volumes of contracts and in the end you would have a positive effect. So I'd like you to please comment on these topics.

A - Gustavo Estrella {BIO 18109709 <GO>}

Marcelo, thank you for your question. Well, first of all, there's a huge in definition in relation to these topics. I think we've had rationing in 2000 -- the market was completely different. So you can't use those measures of 2001, the way that the market is today, more open, many more players. So different sources of generation, the complexity nowadays is much higher. So perhaps as basic premises in any initiative as this from an incentive measure for non-consumption up to reduction in the peak of consumption or rationing, which would be an extreme measure. I think, this has to be discussed widely to preserve the contracts and especially the distributor contacts. This was done in 2001 and in different context. It was done. Our vision is that it shouldn't be different now.

I think, any measure that is linked to rationing or rationalizing the consumption of energy this has to be discussed and how this effects the concession contracts of the distributors and some measure has to be taken to avoid a negative impact. So I think this is the basic premise we have followed closely, these discussions and once more the complexity of implementing a measure such as this is much, much bigger than in the past, but this precondition has to be preserved in any condition. I think this is our position. And I think that this has to be followed ever since simpler measure of rationalization till the more serious measures.

If we are in a scenario rationing, I think that we have to have a discussion very similar to what we had in 2001, where we had compensation measures and rebalancing the contracts, it cannot be different, the sustainability of the sector long-term, I don't see that it would be different in such a situation.

Talking about generation specifically, for example, when, let's say, the government makes campaign to reduce consumption, and so what happens is that you reduce and you will worsen the GSE [ph] that would be negative for hydric generators in general. If you have an official declaration of rationing, let's say, 10% for load reduction, you reduce the volume

of the sale of contracts, and then this would have a less negative impact than another fact, I don't know, if you have sort of this for the generation effect.

Look if we come to a measure such as this of 10% rationing. I think, the impact that you have in the whole supply is large. We can't see an isolated effect of one segment or another. So once more I think, we'll have to sit down. This is going to depend on the type of generation. We have -- some that have they are different we have the free market. There's so many variables on the tables that I don't think -- I think will have to have an ample discussion of all the rules of the sector. That's why it's so complex. But I -- in an isolated fashion, I don't think that we can imagine that we preserve the regulation the way it is for some and for others. I think it's good to be in balance for each peg segment for the business and in each segment for each player that is in this business. So we -- if there is rationing, we will have to have a huge rediscussion to rebalance the sector in general.

Q - Marcelo Sa {BIO 16454581 <GO>}

Thank you. Thank you for your reply.

Operator

Thank you, Marcelo for your question, for your participation. Let's go to the next question, it's from Carolina. Thank you, Carol for your participation.

Q - Analyst

Thank you. I have two questions about regulatory issues, the first one. If you could please comment about the discussions of possible new update of accounts and now has updated from BRL6 to BRL9, but there's a pending discussion of this going up to BRL11, and comment a little bit, how do you see the coverage today compared to the plants that of the sector due to the situation that you mentioned? Also the regulatory agenda because of short-term, we don't talk about losses regulatory issues. So do you have an expectation of when these topics will come back to the now agenda?

A - Unidentified Speaker

Good morning, Carol. I'm Andrea. I'm the Director of Regulatory Issues. Well, the first question we're still discussing. It's a public consultation now and what we have here in this last month the costs, the hydrological costs and these costs have increased. So in general, we have signaled -- the distributors have signal that it would be prudent to regulate this red flag, but we're still discussing this. So now has not yet defined, if it's going to maintain the flag in the current status or if it's going to update. This is a discussion when this last update was done and it's now open the second phase of public consultation. We do not have further details about what an else is going to do into our discussion phase.

As for the regulatory agenda, it has in fact been sort of run over by a series of other topics. The pandemic itself had other topics that sort of ran over the agenda, but the discussions they continued in parallel and all the distributors society as a whole contributed. We continue following these topics, especially the regulatory operational

costs or the losses as you mentioned. And we are going to continue monitoring this because these tariff revisions they take place in 2023 for the larger part of the distributor. So we have to have some sort of a definition between the second semester of next year -- second semester of this year and the first semester of next year to be able to apply this in 2023.

Q - Analyst

Thank you for your response.

A - Unidentified Speaker

Thank you, Carol. Thank you, Andrea. Well, folks we don't have any more questions and we are now ending the session of questions and answers. If there's any question, our department of Investor Relations is available to answer. For those who -- we have a new site with much more information, don't forget to access and leave your feedback. It's very important for our continuous improvement to have more transparency and with more information for you. So I'm going to give the floor back to Gustavo Estrella for his final words.

A - Gustavo Estrella {BIO 18109709 <GO>}

Thank you. Well, I want to thank you for your participation. I want to say that this semester, we're very proud of our team, we're very proud of everything that we achieved. I think that we are delivering robust and expressive results, good results allied here to dividend declaration, which reinforces our commitment with our shareholders. And at the same time, we're able to deliver growth, the CEEE-T and the Gameleira Complex. I think all this together shows the perspective that we have for our CPFL business, for our growth plans.

We're here in discussions of strategic planning for the next years of the company and this gives us a lot of strength to go in search of quality, efficiency and new opportunities of growth. Once more, thank you very much and I wish you a great afternoon.

Operator

Thank you. We now end the results of the second quarter of 2021 CPFL Energy. Thank you all for the participation. Have a great afternoon, and a wonderful weekend. Goodbye.

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