

Q1 2020 Earnings Call

Company Participants

- Gustavo Estrella, Chief Executive Officer
- Luis Henrique Ferreira Pinto, Regulated Operations Vice-President
- Yuehui Pan, Chief Financial Executive Officer and Investors Relations Officer

Other Participants

- Marcelo Sa
- Thiago Silva

Presentation

Operator

Good Morning, ladies and gentlemen. We would like to welcome everyone to CPFL Energia First Quarter Call. Today, we have with us the executives, Mr. Gustavo Estrella, CEO of CPFL Energia; Mr. Pan, CFO of CPFL Energia; and other officers of the company. Due to the COVID-19 pandemic, all officers are connected from their homes. Thus, we apologize in advance if there is any disconnection. Moreover, we're working forward work order re-establish communication as soon as possible. The presentation will be available for download is this website, www.cpfl.com.br/investorrelations.

We would like to inform you that all participants will be in listen-only mode during the company presentation. At the end, we will hold a question-and-answer session when further instructions will be given. (Operator Instructions) It is important to mention that this call is being recorded.

Before proceeding, let me mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of CPFL Energia management and on information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of CPFL Energia and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Gustavo Estrella. Mr. Estrella, you may proceed.

Gustavo Estrella {BIO 18109709 <GO>}

Good morning. We would like to thank you for the present and we hope everybody is healthy. And now we have a different format of our results earning conference call about the first quarter of 2020.

Let's go to slide number 3 with some highlights of the quarter. A reduction in our concession area in the load of 0.2% still with a little effect of the pandemic on the result, but our load already reports this as of March. A reduction in consumption of energy, our EBITDA was BRL1,696 billion with a growth of 10.8% vis--vis 2019. Net income with a growth of 58.5%, reaching BRL904 million. Our net debt, it has a reduction reaching BRL15.1 billion with a leverage of 2.21x net debt EBITDA ratio.

I would like to remind you that we keep our leverage very comfortable for the group, investments reaching BRL516 million with a growth of 15.9%, 90% of these investments go into distribution. We had a tariff adjustment approved by Enel for CPFL Paulista in April of 6.05% for consumers and 6.92% in our Parcel B, and the first one was opened to July 1, and this reflects the transfer of the IGPM, and this is a new event in this quarter. We had the postponement of the application of our adjustment for 90 days. So the application of the tariff adjustment was postponed because of the pandemic. We have good news about the Delisting Tender Offer of CPFL Renovveis registered with CVM on April 27, and the auction will occur on June 10.

We started to participate in the CPFL Energia -- the entry of CPFL Energia shares in the Ibovespa in the B3 as of May 2020. So we will be participating in the Ibovespa of the Sao Paulo exchange. The CPFL Energia won the Equities Deal of the Year 2020 - Americas granted by The Banker, because of its 2019 Re-IPO of BRL3.7 billion. Another important event was the recognition by Enel of CPFL Santa Cruz is being recognized as the best distributor in the country for the Global Continuity Performance or DGC because of the levels of ELC or side of the company.

On the next slide page number 4, we give you more details about our sales performance. As we said our load in the concession area went down by 0.2% with a positive growth of 4.3% in free clients and the captive clients 3.2%. Because of the pandemic, we see a drop of sales in the concession area of 1.6% and we will see afterwards details. In residential and commercial, this drop of 2.9% and 2%, very much impacted by the temperature. The temperature was very high at the beginning of the year.

So we have an effect in the comparison with 2019. The drop in the market mainly driven by temperature reasons in the industrial area, a drop of 1.4% with a non-recurring effect of the migration of two clients of high voltage for direct connection. Net of this effect of migration this has no effect whatsoever practically, and our result for this market, 0.2% drop in industrial. And when we breakdown, we see some segments with some positive variation here a 2% -- pulp 2%. Chemical, 3.2%, wood products with a drop of 4.16%; vehicle, 3.8%; and metallurgy 3.2%. Consolidated, it is flat net of the migration of these clients that I referred to.

On page number 5, we see our delinquency and energy losses. The delinquency reaching 0.77 with 57.9, and there is no impact of the pandemic yet on the results. And comparing

on a year-on-year basis, we see an important drop of 15% vis--vis last year and this drop is driven by our program of power cuts. We can see 30% vis--vis 2019. It is one of the two that we have in order to control delinquency. So you can see that we had a drop in our ADA in this period, vis--vis the previous quarter. There is an increase, and this increase is influenced by non-recurrent effect in the fourth quarter of last year and basically some renegotiations that we talked about during our call -- our previous call. And net of the effect of the renegotiations, we would have practically stability vis--vis these quarters.

Now talking about losses on the same slide. We see a calendar effect. And because of that, we see a change in the percentages of losses in the last 12 months when you adjust for the calendar from March 2020 compared to March 2019. We see practically stability vis--vis the percentage of losses and this is a figure that we track very closely going from 8.84% in March 2019 going to 8.98% in March 2020, adjusted by the calendar. So you can see that the losses are practically stable vis--vis the last 12 months.

On the next slide on page 6, we see the performance of our generation. So we see a major drop in our spot price even more so in the second quarter of 2020. In generation, we have the seasonality effect, and this affect our GSF/secondary, energy going to 102%, and this effect tends to be offset over the year. In the case of SHPPs, you can see a reduction in flow of almost 9%, and this is a very positive result regarding the flow in Minas Gerais growing compared to 2019 of 240%, and then the south region with a drop of 6% in the period.

In wind energy, two effect. The first one that causes a drop of 16% of our generation. We see a lower performance of winds in Cear combined or partially offset the availability in the three regions Cear, Rio Grande do Norte and Rio Grande do Sul, and with the SUO machines, where we see a highlight -- important highlight in the performance of the equipment in the last 12 months.

Slide 7, I give the floor to Pan, our CFO to continue the presentation.

Yuehui Pan {BIO 20609514 <GO>}

Thank you. Thank you, Gustavo. Good morning, everyone.

Turning to slide 7, this quarter EBITDA amounted to BRL1.7 billion, increasing by 10.8%. The Distribution segment posted an increase of 16%. The greatest gain came from market and tariffs, totaling BRL135 million, mostly due to an increase in tariffs related to adjustments in 2019 and also Piratininga's review, in addition to the 0.7% increase in the concession area load with adjustments.

Another important effect was our financial asset of the concession, which increased BRL74 million, owing to an IPCA of 1.62% in the first quarter of 2020 and compared to 0.9% in 2019. Last year, we also posted BRL34 million from PIS/Cofins over Santa Cruz ICMS. The sum of PMSO and ADA increased BRL9 million and other effects on EBITDA with a negative impact of BRL9 million. In trading services and others, the strongest impact was

on trading, owing to a drop in margin of BRL30 million. The services segment and the holding company decreased by BRL7 million and BRL4 million, respectively.

The next slide shows conventional generation in which EBITDA was 6.3% higher, favored by pass-through of inflation in contracts, BRL24 million. The effects of Epasa's overhaul last year, BRL11 million, and the lower thermal generation this year negative with BRL15 million were virtually offset. As for CPFL Renovveis, EBITDA increased 16.1% due to gain of PPA seasonalization in SHPPs of BRL54 million.

And biomass gains with seasonalization of contracts and higher generation implants, BRL15 million; gains with inflation effects on energy contracts BRL12 million, and these effects were offset in part by lower revenues with GSF in SHPPs due to the fact that it is secondary energy, negative BRL29 million. And lower wind farms generation negative BRL25 million.

Slide 9 shows the performance of our net income, which amounted to BRL904 million in the quarter, increasing 58.5% vis--vis the first quarter of 2019. In addition to the variation of BRL165 million in EBITDA, there were gains in the financial result that totaled BRL341 million. Depreciation varied BRL22 million and taxes increased by BRL150 million.

It's important to highlight that we had an important effect in the financial result related to mark-to-market MTM, which totaled to BRL260 million, owing to the large volume of funding. Nearly BRL3 billion at an average cost of CDI plus 0.8% in a four year timeframe, while the market already began to feel the crisis of COVID-19. Please note that the gain in mark-to-market will be returned in the future as the scenario of risk spread comes back to normal and as we get closer to the maturity date of these debts. However, this result reflects the cost avoided in this moment of crisis since our conservative prudent profile which anticipated cash management to 2020. In addition, the decrease in CDI and the lower net indebtedness generated gains of BRL67 million.

The next slide shows the company's net debt over EBITDA ratio. On the first chart, net debt totaled BRL15.1 billion and EBITDA in the last 12 months amounted to BRL6.8 billion. The leverage measured by net debt over EBITDA was 2.21x.

On the next chart, we see the cost of debt in recent years, both in real and nominal terms. The decrease in the first quarter of 2020 is mostly due to a reduction in the interest rate, SELIC rate. As for the composition of the gross debt, we can see that 67% is pegged to CDI. This position became stronger with the new funding in the first quarter of 2020. CPFL has BRL2.9 billion in new funding, with an average tenor of four years and all-in cost of CDI plus 0.8%.

In addition, in April, we signed a contract with BNDS in the amount of BRL3.5 billion, a 20-year tenor and the first disbursement is expected to happen in the first half of the year, accounting for approximately one-third of the operation. At the end of the first quarter of 2020, our cash amounted to BRL5.6 billion with a coverage index 1.78x short-term amortizations. The average amortization term is 3.15 years.

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Slide 11 shows our CapEx. This quarter, we invested BRL516 million, an increase of 16% year over year. A breakdown by segment shows in distribution total investment of BRL454 million allocated to expansion upgrade and maintenance of the electrical system. For generation and transmission, BRL30 million to Genovaves, keeping projects Gameleira and Cherobim in progress. For transmission, BRL8 million earmarked to projects, Maracana, Sul I and Sul II and BRL1 million for conventional generation. Lastly, for the service segment, we allocated BRL24 million.

Thank you very much. And now I give the floor back to Mr.Estrella. Thank you.

Gustavo Estrella {BIO 18109709 <GO>}

Thank you, Pan. Moving now to slide number 10, let me tell you more about our efforts vis-à-vis COVID-19 and how we are getting the company ready to face the pandemic. So I think we were very prompt to mobilize the company in mid-March, allowing ourselves to be ready and check the progress of the pandemic and the impact on our business. So from the very beginning, we started a crisis committee. We have daily meetings to discuss the main topics, analyze the main indicators, identifying any changes in routes if necessary. All the major executives take part in these meetings. We make decisions to be ready for the crisis.

Another important point. We've been firmly guided by the experience from other areas. So two good measures were made and we anticipated ourselves owing to State Grid experience like buying masks, alcogel -- alcohol gel, and some measures that we anticipated based on State Grids' experience. And it helped us a lot to have under control the speed of infection at CPFL. And here we show some pillars. The most important one is a very strong focus on safety and health of our employees. A number of measures like cancellation of events and travel, monitoring the health status of employees with daily reports, identifying signs of fever or symptoms, distribution of masks, alcohol gel, so we can actually protect all our employees and do the best we can in our current practices in the company. We have a daily safety dialogue. Before our teams go to the field, we have conversations about safety, everything related to COVID.

In parallel, considering the honesty behind our activities, we're all aware of the importance of completing our activities, not only at CPFL, but the society at large. So that's a critical topic for us, and we've been in a daily follow up by the executives of the company. So we have home office now. That's a topic being discussed for a long time at the company. And within two weeks, we had 80% of our employees, more than 4,000 people working from home all at once. We didn't know exactly how the dynamics would be at first. The impact on our work, our system, communication, but a good surprise is that everything is running very smoothly.

Another important point is that we have our call center units concentrated and the volume of people also working in the same site. So we began to decentralize these workstations, and recently not only decentralizing, but also using home office regardless of the call center independently. So more than one-third of our call center is working remote from home and also working very well.

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Another challenge. In addition to the disconnections, we also had some closing of our agencies and that's a challenge of digitalization. So we can actually educate our customers, so they use our digital channels. This is already happening. Today we have 90% of service via digital channels, and this is also very positive. And just as we did with call center, we do the same with our operation base and substations, preventing everybody to be on site. So we're working on smaller groups, so should we have any infection which fortunately never happened, maybe we can have a more proper isolation by working with smaller teams.

Now on the next slide, we show a sequence of our measures for the crisis. So very much concern, and we have a contingency plan to assure operation continuity. This crisis brings a lot of uncertainty, and it's hard to predict the crisis and how it can evolve and affect the society and our business. So we have this idea of working on a contingency plan to assure and preserve the continuity of our business and a very strong effort on our IT and information security systems. We largely and increasingly depend more and more on our IT area. So that's a core topic for us today and we're constantly monitoring our teams.

Physical segregation of operation is another item applying both for distribution and generation. Everybody connected but with remote operations, including commercial ones in order to prevent physical contact. And also, mapping and recycling professionals for backup for emergency situations. Fortunately, we didn't have any infection case yet. So the financial aspect is also very important now, particularly when it comes to liquidity. So this is also part of CPFL's strategy to anticipate items, preserve liquidity, and like Pan -- well, Pan showed our cash position which is very robust, making us very comfortable to move forward in the next months and overcome the crisis.

I also mentioned the digital channels and a lot of enhancements and improvement in our relation -- customer relation channels, improving our website, our web IVRs, use of chatbots and providing free Internet for anyone who uses our app. So the idea is to encourage the use of digital channel. So these are many changes that will apply not only to this moment of crisis, but also in the post-crisis time, so we can expedite our service to our customers and also a better quality of service perception.

Also an important increase in the number of accounts per month BRL3 million in a universe of BRL9 million, a significant increase also affected by the beginning of the crisis. New payment options. Now we have a physical -- well a high rate of physical payment term. This is for the industry, the electrical system in general, but we are also encouraging new payment option, digital options.

And now last month, we started to offer a credit card option. And basically the teams are also showing the delivery collection. Now we have 97 teams in this implementation of collection by using POS machines for that purpose. So when we have this crisis with a lot of uncertainty, what we do is to have daily meetings to check the moves and try to position CPFL in all its areas, so we can always make the best decisions, always focusing on health, safety and the continuity of our operations, maintaining more financial liquidity. So unfortunately, we know it will still happen for the next weeks. So we still have to be working from home remotely so we can face the crisis and also assure our safety. So that's what we had.

Once again, we thank you all for being with us, and we'll be here to take questions during the Q&A. Thank you.

Questions And Answers

Operator

(Question And Answer)

Ladies and gentlemen, now we will start our Q&A session. The session will be in Portuguese with simultaneous translation into English. (Operator Instructions) our first question come from Thiago Silva from Santander.

Q - Thiago Silva {BIO 17655676 <GO>}

Thank you for the question. Congratulations for the results. I have two questions. The first one has to do with losses. I understand that the calendar was unfavorable in the concession area. However, I would like to understand and maybe you could give us some color about it. How are you positioning yourselves as you are close to the target of the regulator? How are you positioning yourself? Because this is a very sensitive situation that is to say when you exceed the regulatory level, are you sensitive to that because of the situation of the COVID-19 pandemic?

And the second question. We are all expecting a presidential decree. But based on your talks with the regulator and your communication with them and also based on the measures that have already been taken or mentioned in terms of liquidity, is there any problem for CPFL? Or is there any situation that should draw our attention not only regarding CPFL but the whole sector when we see measures beyond the ones that are regulatory measures?

A - Gustavo Estrella {BIO 18109709 <GO>}

Thank you for the question. This has been exhaustively discussed with the regulators and Enel and the companies in the sector, and there is a positive side to these talks. And the idea is to preserve liquidity not for the company alone, but for the whole sector. We believe there will be an increase in costs and...

Operator

The interpreter apologizes because it's very difficult to understand what Mr. Gustavo Estrella is really saying. We apologize.

A - Gustavo Estrella {BIO 18109709 <GO>}

So there is one function regarding preservation the liquidity of the distribution companies, but also you have to think about the transfer of tariff adjustments. So these are the two main objectives. Your question is very timely, because we need a very quick answer

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regarding this liquidity issue. And the reality among the company is rather different among the companies in the sector. And of course the need of the whole sector have to be met.

There will be -- we have already had some talks with the regulators and the ministry and the theme of equilibrium is very important. We have been seeing the market performance regarding delinquency already giving an impact or having an impact on April already and it's very difficult to foresee. But anything the scenario that we foresee is not positive in this regard. So this is an extraordinary situation. It is a one-off situation in a pandemic such as the one that we are living today together with the theme of delinquency.

So our main tool is the cut of the energy. This is the reality that we are living today, and the perspective is for an increase in delinquency. So this would bring a relief in terms of cash and for consumers as well. About the losses, would you like to say something?

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

Good morning, Thiago. This is Luis Henrique. With relation to the losses, we are working very hard on inspections. We have already had 188,000 inspections in April and these inspections are giving results mainly on Groups A and B, the ones where you have the biggest losses. Then all the companies in the sector have been operating with losses higher than the limit of the regulator. This has to do with the regulation that was established way back then. And with this effect on this crisis, this pandemic situation, we have not stopped inspections. We are doing this very carefully protecting our employees and our clients as Gustavo said, but we continue to carry out our inspections.

And the calendar effect ended up hindering they sent in April. We already have a change in the situation because of this calendar effect that led us to have this small increase, but the losses are very well under control. And during the pandemic, we are evaluating very well all these issues and we are monitoring consistently and with the telemeasuring in RTE, and then we can cover all the A group, and then we have more assertive inspections and working very strongly regarding the quality of the inspections so that we may keep losses under control and some -- our distribution companies are getting to the regulatory level. They're getting close to this level and our trend is to work so that everybody may go to the regulatory level. This is our plan for the next few months and years as well.

Q - Thiago Silva {BIO 17655676 <GO>}

Just to add to what you said. And is Enel sensitive in terms of mitigating the impact during the pandemic, mitigating some situations of losses? Do you see any goodwill on the part of the Enel?

A - Gustavo Estrella {BIO 18109709 <GO>}

Well. As we said the first impact was that and we have been discussing this with Enel in the losses as they are stable. We have already opened a discussion with Enel and we have already submitted this concern to Enel, not only our company, but all the companies in the sector. Because some period you have no cut, then all of a sudden, you have a lot of cuts. And depending on the economic situation of the population at the moment, there could be an increase in losses, but we are preparing our plan and we are studying our

plan in order to tackle this. So far, what we have seen up to now is that we see no oscillations. We have things very well under control and the figures are surprisingly good as far as we are concerned. But we are talking with Enel, because in case of a big distortion, Enel should recognize this exceptionally.

Q - Thiago Silva {BIO 17655676 <GO>}

Thank you very much.

Operator

Marcelo Sa, Itau.

Q - Marcelo Sa {BIO 16454581 <GO>}

Thank you for the call. I have two questions. The first one has to do with the decree that everybody is expecting with a package of adjustments and or leaving open the economic side. And I would like to know if the idea is to have something very clear that is to say guaranteeing some measures -- financial measures. And in this decree, do you think it will be enough for distributors to recognize a CVA to avoid an immediate impact on the next two quarters? And the second question has to do with the limitation for three months of cuts of delinquent clients. Do you think this could be further extended?

A - Gustavo Estrella {BIO 18109709 <GO>}

As I said before, the decree is very much focused on the financial side, so it is basically a measure to anticipate cash or bring forward cash. So this discussion regarding equilibrium is under the responsibility of Enel and not the ministry itself. So we expect a decree in this direction. Our expectation is that in the decree we might have something included regarding this overcontracting, and this will be addressed in further talks with us.

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

Yes, Gustavo I think this is it. As you mentioned yourself, in the talks that we have been carrying with the regulator that could be some more clear mention of over-contracting. But this should be studied very carefully in terms of the assets.

About your second question, we have no information whatsoever regarding the extension of the three-month period. But the crisis or the pandemic, the way it is happening here in Brazil, more specifically in the state of Sao Paulo, we believe that this could be extended a little bit further. If we get into a more critical situation, we believe this is a possibility. This will be a possibility. But again this crisis is such a new scenario, so unprecedented for everybody that measures taken will probably have to be reviewed for all the sectors.

Q - Marcelo Sa {BIO 16454581 <GO>}

Thank you very much.

Operator

(Operator Instructions) This concludes the Q&A session. I would like to give the floor back to Mr. Gustavo Estrella for the final remarks.

A - Gustavo Estrella {BIO 18109709 <GO>}

Okay. Once again, thank you all for joining us today. So my final remarks are that these are tough times that we are all going through. It relates to our professional activities, but also our personal lives. And with a lot of uncertainties in this scenario for the coming months, so our word of order is to keep focused and disciplined. And also being united at the company, focusing on what I said, health and safety, maintenance of operations and the liquidity of our company.

And in parallel to that, we're opening discussion fronts, particularly in the regulatory framework, involving loans, discussion of the financial economic balance, so we can have robustness in our industry after the crisis. To some extent what we've been doing is to have internal conversations about the world after the crisis, after the pandemic. So, we also be focusing on digitization and undoubtedly considering new ways to interact with our customers, considering good opportunities and also considering our working relations which will also be different.

So it's only natural to use video conferencing now, working from home office is no longer a taboo. We see that in many companies. Home office is efficient and it can be very positive too. So the idea is to consider to imagine what our business and company will be after the pandemic. And also remembering that during crisis, we also have opportunities. If we consider the soundness not only of CPFL but our shareholder, we have to keep an eye open on many opportunities that the future may bring.

So once again, thank you very much. We are all here for you for further discussion and questions. Have a good day. Thank you.

Operator

This concludes CPFL conference call. Thank you for joining us today. Have a good day.

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