

Q3 2016 Earnings Call

Company Participants

- <A]>
- Antonio Sérgio de Souza Guetter, Chief Executive Officer
- Luiz Eduardo da Veiga Sebastiani, Chief Financial Officer & Investor Relations Officer
- Luiz Fernando Leone Vianna, Chief Executive Officer & Director
- Sergio Luiz Lamy, Chief Executive Officer
- Unverified Participant

Other Participants

- Lilyanna Yang, Analyst
- Maria Carolina Carneiro, Analyst
- Pedro Manfredini, Analyst
- Vinicius Canheu, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Conference Call to present the Third Quarter 2016 Results of Copel Companhia Paranaense de Energia. We would like to inform you that all participants will be in a listen-only mode during the call. Later, we will hold a Q&A session when further instructions will be given.

Before we proceed, let me mention that forward-looking statements made during this call regarding Copel's business, projections, operating and financial targets are based on beliefs and assumptions of the company's management and also on information currently available to the company. They involve risks, uncertainties, and assumptions because they relate to future events and therefore depend on circumstances that might or might not occur. General economic factors and other operating factors might influence the future of Copel and lead to results which differ materially from those expressed in these forward-looking statements.

With us today are Luiz Fernando Leone Vianna, the company's CEO; Mr. Luiz Eduardo da Veiga Sebastiani, CFO and Investor Relations; Mr. Jonel Nazareno Iurk, Business Development Officer; Mr. Gilberto Mendes Fernandes, Corporate Management Officer; Antonio Sérgio de Souza Guetter; CEO of Copel Distribuição; Mr. Sergio Luiz Lamy, CEO of Copel Geração e Transmissão; Mr. Ricardo Goldani Dosso, CEO of Copel Renováveis; and Mr. Franklin Kelly Miguel, CEO of Copel Comercialização. The presentation which will

be delivered by Copel's management may be followed on the company's website, www.copel.com/ir.

So now we would like to ask Mr. Luiz Fernando Leone Vianna, the company's CEO to take the floor. You may proceed.

Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

Good afternoon and welcome to the third quarter Copel earnings conference call. I would like to thank you very much just for being here. It's always a pleasure to talk to you. I would like to start our conversation talking a little bit about the operating highlights of the company. This was the first quarter of Copel Distribuição with the effects of the result of the fourth tariff cycle review. Although the downturn in the consumption of energy had negatively impacted the results of the distribution company, the remuneration of the new asset base allowed with a good EBITDA to come back to positive figures. The results could have been better if it were not for the continuous crisis in the distribution segment which suffers from the energy consumption, reduction, and inflation effects.

In transmission segment the highlights are the remeasuring of the cash flow estimates which refers to the RBSE. As you already know, the MME through the Ordinance 120/2016 published in April this year determined the integration of R&BSE based on regulatory remuneration and updating of asset values since 2012 and with payment of indemnity through the RAP as from new tariff process of 2017. Based on the best estimates available at that moment, the company posted a positive effect of BRL 978 million in the operating revenue of the second quarter. However, based on a new inspection team notes that signaled that a massive amount would be received in that estimation in the second quarter of 2016, we remeasured the cash flow which concerns RBSE which has led to a reduction of BRL 206 million in the asset balance reflecting on the earnings of the third quarter as we have shown in slide 3. It's important to mention that ANEEL has still not yet ratified the final result of the report and the values recognized are based on the best current estimates of management. Besides that, we must remember that the improvement of the regulation concerning the calculation of the cost of capital to be added to the RAP of transmission utilities is up for public hearings.

On slide 4 we would like to talk a little bit more about our investment program. 2016 has been a year of challenges. But with a lot of work and perseverance we are achieving our objective and improving our company. We have already carried out about 84% of the CapEx predicted for 2016, totaling more than BRL 2.7 billion in investments until September of this year. A very important part of this investment is used for finishing some projects like the small hydroelectric plant of Guaraciaba which received its operating license which was granted on the 13th of August, allowing the commercial operation of more than 600 kilometers of transmission lines and a substation, adding an RAP of BRL 49 million for Copel. Another project was the conclusion of a transmission line of 967 kilometers which belongs to the Paranaíba plant which is awaiting the issuing of the operating permit to begin commercial operation, and we believe that this should happen until this month, adding BRL 22 million to Copel's RAP.

FINAL

Bloomberg Transcript

Looking towards the next year, in 2017 we foresee the conclusion of another four transmission projects which altogether will bring about an increase of BRL 195 million to Copel's RAP. In the generation segment we will conclude the Colíder hydroelectric plant and the first phase of the Cutia wind farm which includes 7 of the 13 wind farms which take up the complex and it will come into operation in October 2017, adding to Copel's portfolio another 632 megawatts of installed capacity.

FINAL

Before we ask our CFO to talk about the figures of the third quarter, I would like to talk about Copel's anniversary. On the last 26th of October our company celebrated its 62nd anniversary and celebrations once again came in the form of recognition. This year we received several awards among which I might mention the Abradee prize for the Best Energy Distributor in Brazil according to the client evaluation. This is the fifth time in the last six years that Copel Distribuição has received this prize. Copel Distribuição also was elected for the fourth time in the last six years as the Best Distributor of Latin America. The award is promoted by the Comissão de Integração Energética Regional, CIER, main entity for the council of electric power sector. And also, our distributors won the Transparency Award of 2016 which is by the National Association of Finance, Administration and Accounting Executives (sic) [National Association of Executives in Finance, Administration and Accounting] (08:59), ANEFAC. After 14 years Copel has come back to the ranking which recognize the quality and transparency in accounting information rendered to the market and the only stated-owned company among the five companies of the electric sector awarded in the 20th edition.

Now I'd like to ask Sebastiani, our CFO and Investor Relations, to take you forward and he will go into further detail about the period's earnings.

Luiz Eduardo da Veiga Sebastiani {BIO 17969160 <GO>}

Thank you, Mr. Vianna. Good afternoon and once again I would like to thank you all for being here. Good afternoon and I would like to thank you for being at this call. As President Vianna has already said, some non-recurring events affected the results of the third quarter and we will talk about that on slide 5 and the following ones.

In the line of operating revenues we made mention three facts which contributed to the downturn of 10% compared to the third quarter 2015. The supply to end customers which showed a reduction of 24%, totaled about BRL 1 billion, was impacted by the result of the fourth cycle of tariff review of Copel Distribuição which reduced tariffs about 13% since 2014 and by the reduction of 9% of attractive markets, a reflection mainly of the migration of customers to the free market. The electric power sale to distributors totaled BRL 684 million and showed a drop of 9% which stems from the marked activation of the (10:43) thermal plant partially offset by sale of energy on the short-term marketed by Copel Geração e Transmissão. Revenue from the use of the power grid was BRL 503 million, a downturn of 22% regarding the third quarter 2015, a consequence of the impact of BRL 206 million which refers to the remeasuring of cash flow of assets regarding RBSE as our CEO has said. The other item of operating revenues made up by the telecom revenues, gas and other distribution showed a growth of 16% reflecting mainly the increase of 16% in Copel's telecom revenue due to an expansion of plans with the customer base.

FINAL

The next slide, 6, we detail the costs and operating expenses which were BRL 2.7 billion in the third quarter of 2016, 14% under the same period of 2015 which is assigned greatly to the reduction of 19% on the costs of the purchase of energy (11:58) of energy contracts which was substituted by contracted energy which comes from the quota system and the reduction lead by full tariff. The charges for the use of the grid showed a drop of 6% due to the lesser expenses with charges from the reserve energy. The manageable costs was up 5% in the third quarter of this year and reflects more expenditures with personnel and third party services offset by the loss reduction in the switching off and sale of assets when compared to third quarter 2015. The line of provision and conversion totaled BRL 108 million and was influenced by the booking of BRL 49 million which refer to administrative and labor litigation, BRL 34 million tied to loan loss provisions, and BRL 15 million which refer to the loss of the reduction of the impairment of the consortium Tapajós.

Slide 7 shows that EBITDA was 43% year-to-date compared to the books in the same period last year, totaling BRL 428 million in the third quarter of this year with a margin of 15% on operating revenue. The growth is broadly explained by reduced costs which (13:21) and the result of fourth cycle tariff review with Copel Distribuição. Cash generation at Copel Generation and Transmission accounted for 51% of the EBITDA, consolidated and Copel Distribuição 21%, with Copel Telecom 7%, and other companies in the group accounted for 21%, and the major contribution (13:45).

Slide 8 shows us the net profit consolidated of Copel. In the third quarter the company's result was negative BRL 75 million compared to a net profit of BRL 91 million registered during the same period last year. This result is impacted by greater expenses, financial expenses, the reflection of a greater balance for financing and debentures and the provision of BRL 122 million for the non-letting and the social contributions deferred on assets and regulatory cash liabilities of Copel Distribuição. And analyzing the result of subsidiaries, Copel Generation and Transmission closed the period with a profit of BRL 45 million, Copel Distribuição a loss of BRL 127 million, and Copel Telecom a profit of BRL 13 million. It is important to say that year-to-date the company has booked a net profit of more than BRL 1 billion which is a growth of 23% vis-à-vis the same period in 2015.

Before we go onto the question, I would like to remark that we are concluding the development of the new website of IR with investors which should go live in the next few days. The reformatting of this website has had as an objective to improve one of the main communication channels of the company with investors, capital markets professionals, and the public in general with a more modern and simplified layout and an easier menu to navigate. The new website shows an efficient organization and bringing more quality and agility for the users, reinforcing the commitment of the company regarding transparency and access.

So these were our highlights and we are now available for questions. Thank you very much.

Q&A

Bloomberg Transcript

Operator

Ladies and gentlemen, we would like to start Q&A session for analysts and investors. Our first question comes from comes from (16:05) You may proceed.

Good afternoon and thank you for the call. I would like to know if there's anything new regarding the balance of the company and the main point of the balance sheet?

A - Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

I'm sorry. We did not understand. We couldn't hear you properly.

Q - Operator

Thank you, CEO. Is there anything new regarding those items which were lost in the balance sheet, like a typical question of (16:43) which you have. And any other items of the balance sheet, what the impact was in comparison (16:59) strongly in the last trading discussion. I'd like to know if there is any novelties there?

Thank you, (17:12) I would like to ask the superintendent of accounting of the company to take the floor.

Good afternoon, (17:18) and all. We did have some diverted to the first half of the year as you mentioned some examples. And regarding (17:30) we closed the negotiations with those responsible and you can see in the contingency notes about 70 million shares classified as possible loss (17:47) and we reinstated BRL 130 million which were probable accounts receivables, about BRL 50 million. So we received communication regarding this subject. I'd say that it's one of the main events of the quarter which influenced our contingency accounts. Another example is (18:12). It continues. We had last quarter a significant reduction and we had the second (18:20). We also have got on with this and there will be a possibility of reversion still this year. We should have good news regarding the second pursuit. One event (18:42) in this quarter was the provision of non-activation of the deferred income tax. This is a provision and we're still discussing internally with our consultants and we should go after these credits again, but they negatively impacted our performance in the period. Thank you very much.

Our next question comes from Carolina Carneiro from Santander.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Good afternoon. I have two questions. The first, do you have any updates on the commercialization of energy of the generator of free energy 2017, 2018? Have you closed new contracts? And second, the cost performance. You said that you were going to hire a consultancy company to evaluate provisions which (20:03) predicting your cost reduction. There has been an improvement it seems of costs but they are still high especially in the distributing company. So could you give us some novelty regarding the better performance of the distribution company?

A - Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

This is the CEO of Copel, Luiz Fernando. Please I would like to call on Sergio Lamy from Copel Generation and Transmission.

A - Sergio Luiz Lamy

Regarding your question about the level of contracts or new contracts regarding Generation and Transmission, today in the last sale auctions which were held, and the contracts are still to be signed, we managed to get for 2017 82% of contracts of energy in our portfolio, and for 2018 61% contracted, for 2019 51%. This is not our closing position yet for the year because we have already published for the next week (21:31) auction of sale of energy of Copel Geração e Transmissão, where as a prospect we will close the objective of the year for 2017 and also increase a bit more the level of contracts for the years of 2018 and 2019 and 2020. I hope that I have answered your questions.

Q - Maria Carolina Carneiro {BIO 16342681 <GO>}

Can we work with the same price level among this BRL 50 million and BRL 160 million (22:07) or has there been any change in the price levels?

A - Operator

The price level, it's gone up a little bit, Carolina. The price level for this auction, unfortunately I do not have the updated material but it is not exactly this value. It's more let's say about 15% above the value that you mentioned. Thank you.

Carolina, regarding your other question, your second question regarding costs, it's not just a mere coincidence but an important coincidence. Today was the first meeting of the cost management coordinated by the CFO demanding a joint coordination of all subsidiaries identifying good practices in the different subsidiaries and (23:32) best practices can filter down to all the Copel group of companies. So we identified very important practices for cost reductions, cutting of headcounts, reducing the fleet on Copel Distribuição which transfer these practices to Geração e Transmissão. In the same way, Geração e Transmissão transfers it to other subsidiaries of the group. But a job coordinated under the coordination of the CEO of Copel holding company to bring more immediate and practical results regarding cost reduction. So our main objective is to reduce costs, maintaining (24:20) with quality which is so important to Copel, brand (24:25) quality and now we will have also a brand of cost reduction.

And your third question, I will ask the Copel Distribuição CEO to take the call, Antonio Guetter who is going talk about that.

A - Antonio Sérgio de Souza Guetter

Hello, Carolina. This is Antonio Guetter. Regarding costs and cost reduction, let me show the efforts that we have mentioned. To avoid the (25:02) which affected the economic prices but we have had been very strong in our actions and we've had a less level of (25:16) in the year so we have already passed the inflection on the curve and we are improving and we will analyze for loan losses. We have covered that and we had

FINAL

Bloomberg Transcript

unexpected costs. But even with the problem of (25:42) we managed to get a much better loan loss provision. And the provisions are being attacked by the management so to say because these are the two indicators that impacted our business. The loan loss provision and judicial actions, one of our main banners is that of cost reduction especially of the distributor company because it has to be an efficient cost management to reduce the regulatory amount. Thank you.

Operator

Our next question comes from Vinicius Canheu, Credit Suisse.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Good afternoon and thank you for the call. We have seen in the quarter presented volumes that they weren't very high at all, and you had mentioned also that there was the problem of the temperature in the revenue. So anything that you could project for the quarter or for the half year, this weakness from the third quarter will it continue or will there be an improvement?

A - Operator

I'd like to ask Sérgio Guetter from Copel Distribuição.

A - Antonio Sérgio de Souza Guetter

Hello, Vinicius. Well I think as I have said in the previous question, we know (27:17) difficult time. Our markets is reacting at levels show that we are past the worst. Recession is weakening, it's slowing down, and so the results have improved. The tariff review that was made in the middle of the year, we are now reaping the benefits, almost the benefit of distribution which struggles remuneration. So I think with the trend that the numbers are showing, we will have a very good fourth quarter.

Q - Vinicius Canheu {BIO 6300903 <GO>}

Can you give me an amount?

A - Antonio Sérgio de Souza Guetter

No. Unfortunately I cannot give you quantitative data. I can just extrapolate the market which is developing. We had a drop in the first half of the year but it recovered in the second half of the year and the recovery of the market as a whole, and this market reversion is making things more optimistic for the next - the beginning of the first half year.

Operator

The next question comes from Pedro Manfredini, Itaú BBA.

Q - Pedro Manfredini {BIO 21633245 <GO>}

FINAL

Good afternoon. I have two questions. First, regarding the current investment in the distribution company, and you have already got upgraded, you had a review in June so there will be a recurring CapEx from the distributor in the next year or two years. I'm also asking this because we analyze the EBITDA of the last quarter. We will come to an EBITDA with a profit of BRL 400 million in the year. We have a CapEx more than BRL 600 million. So are you going to equate the CapEx to know what the generation of EBITDA of the company will be in the next few years?

And also transmission. Copel just recently had some transmission projects. The factors weren't very favorable now that they are - ANEEL had some new entrants in the auction. And what about Copel? Can we expect 2017 with the completion of several projects? Can we once again see Copel arriving at the same amount? Mr. Sérgio, I'd like to talk about Copel Transmissão.

A - <A]>

Hello, pleasure to speak to you. The distributors have invested significantly in the last few years to return to quality and strengthen our grid where we needed. Idea ever since the renewal of the concession is to continue to invest up to the level that you've already mentioned and our objective is not only to expand our grid but also modernize this grid. Today the distribution in the network has to be modernized and we need a lot of intelligence built in and we will discuss this theme a lot.

A - Antonio Sérgio de Souza Guetter

Hello, this is this is Sérgio from Copel Geração e Transmissão. Regarding your question of Copel's situation in the transmission auction, in fact Copel in the past has shown strong appetite for transmission auctions and at a time when the returns were not all that favorable. But we know that the situation now is more favorable, it's much better, and this does not reduce at all Copel's asset. In the wonderful last auction we won a large lot of transmission of lines and substations here in the State of Paraná and Santa Catarina. We just did not go to the last auction for a strategic reason, and this strategic reason is considering the projects will come up during the next auctions. So I could say to you that we are foreseeing better opportunities much more aligned to our strategic ideas and in the next auctions which will be occurring next year.

Q - Pedro Manfredini {BIO 21633245 <GO>}

Perhaps it's just a follow-up. Thank you. Historically you have partners in this auction. In 2017 will Copel come in with (33:22) or will it be the same partner which you've had in the last two quarters? And anybody contracted to do this project if Copel should win any of the months. This is already something further down the road?

A - Operator

Okay, Pedro. I would say that we are still studying the lots. We already have information of the lots that will be up for auction in the first half of the year. We don't have any information - much information about the segment, but this the first we'll do. And we are studying our partners but we have nothing closed yet. There are several possibilities which will materialize at the beginning of next year. I would say that also completing

answering your question, we are not yet closed regarding the propagation of Copel Geração e Transmissão or with partners. Generally we have a mix. Depending on some lots the auction starts with the bidding of Copel alone. And then depending on the lots, a partner joins us. So all these alternatives are up for analysis and I would say that maybe in February also we will have this program mapped up for the next auction which is being published by the (35:06) Energy for March of next year. Thank you.

Our next question comes from Lilyanna Yang from HSBC.

Q - Lilyanna Yang {BIO 14003234 <GO>}

Thank you for this opportunity. Mr. Sebastiani, are you working with any (35:35) financing and how? And what about revenue for the projects you got and what about cost reduction? And a more strategic question to Mr. Vianna, what about the organic growth for generation, transmission or even distribution? What makes sense to Copel at this moment? And you certainly don't have a level of debt as much as your competitor.

A - Operator

Thank you, Lilyanna. It's a project with (36:20). And regarding the level of betterment, we are always very alert to these problems. We have a good eye on covenants in Copel when it goes beyond a certain level of commitment and leverage which is significant positive for the company. We also have an expectation of improved revenues because of the assets which are coming into operation that are coming this year or beginning of next year which will reduce the percentage of commitment of debt or revenue. And allied to the cost program, we want to increase our investment capacity with equity or maintaining a leverage standard. And we are at the moment at the highest level of the leverage and there will be a drop because of revenue that we are expecting and cost reduction with the results that we will begin to have in the first months of next year we will feel. So this is a daily job. So just keep an eye on revenue and this is influenced by the economic scenario which brings with interesting opportunities to Brazil, slight inflection here on the curve, from recession to stability and growth. So I think we have an interesting prospect for next year but it being of course with constant analysis of the level of debt, increasing revenue, and reducing costs.

Q - Lilyanna Yang {BIO 14003234 <GO>}

What it would be about 2.5 times the net debt of EBITDA or do you think that that's too much?

A - Operator

That's challenging. It's something very complex but we work with levels below (38:50) the feeling we work within our comfort levels. So the company, for example if something pops up, a prospect is invested with important returns like the Copel Geração e Transmissão CEO mentioned, the transmission sector, we will have leverage to make those investment and also the necessary investment for Copel is significant. So we have to have leeway in our debt level so that in the right moment we can use the leverage under favorable conditions. At the moment it is not really most favorable time for funding. But when adequate and have a funding connected to an investment plan.

A - Luiz Fernando Leone Vianna {BIO 2065945 <GO>}

Regarding our investment policy, this is Luiz Fernando speaking, according to what has already been mentioned we are prioritizing new investments in the grid, but we are analyzing generation and transmission and the operations. But we are prioritizing in greenfield investments.

Operator

If there are no more questions, we would like to ask the company for its final remarks.

A - Unverified Participant

We wish to once again thank you for being present in our call and we hope to have you back next quarter. And wish you all a very good week.

Operator

Ladies and gentlemen, Copel's call on the third quarter 2016 earnings is closed. Thank you very much and have a good afternoon.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript