

Q1 2019 Earnings Call

Company Participants

- Gustavo Estrella, CEO
- Yuehui Pan, CFO

Other Participants

- Analyst
- Bruno Varella
- Gustavo Fabricio

Presentation

Operator

Good morning and thank you for waiting. Welcome to CPFL Energia's First Q1 2019 Earnings Results Conference Call. Today, with us are Mr. Gustavo Estrella, CEO of CPFL Energia; Mr. Pan, CFO of CPFL Energia, and well as other officers of the company.

The presentation will be available for download in the website at www.cpfl.com.br/ir. We inform that all participants will be in listen-only mode during the company's presentation. After that there will be a question-and-answer session and further instructions will be given. (Operator Instructions) It's important to mention that this call is being recorded. The call will be held in Portuguese by Mr. Gustavo Estrella, with interpretation in English and we will have the participation, Mr. Pan who will speak English to all listeners.

Before proceeding, 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's management and on information currently available to the company. Forward-looking statements are not guarantees of performance, they involve risks, uncertainties, and assumptions as they relate to future events and therefore, depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operating factors may also affect the future results of CPFL Energia and may cause results to differ materially from those expressed in such forward-looking statements.

Now, I would like to turn the floor to Mr. Gustavo Estrella. Floor is yours, Mr. Estrella.

Gustavo Estrella {BIO 18109709 <GO>}

Good morning, everyone, I would like to thank you very much for being here with us for this call regarding the results of the first quarter of 2019 of CPFL Energia. I'd like to start on Slide 3, where we have our main highlights in the quarter.

The first event was related to an increase in the loads in the concession area, and we have a growth of 1.9%. We're going to go into details with a little bit further ahead, but this 1.9% is related to two free clients that's left our concession areas, they have migrated to the basic network. If we adjust the consumption of these two clients and this load then, we are going to get to an increase in consumption in concession areas to 12.5% in the comparison base, which is around the same amount of growth that we had in consumption in 2018.

And here we have our results, our growth into EBITDA of 12.1%, BRL1.531 billion also an increase in our net income of 36% reaching BRL570 million, and our leverage of net debt of BRL14.9 billion, with a leverage of 2.7 times net debt over EBITDA. Our investment in the quarter were BRL445 million, and like remember that our forecasted investment for 2019 of BRL2.2 billion a year. In this quarter, we had BRL445 million. Our careful adjustment year for CPFL Total Foundation [ph] in the beginning of April, we had an increase that was significant of 9.63% of the Parcel B, reaching BRL2.532 billion with an average effect to our consumers of 8.66%. I think it's important to highlight here probably two important factors in the share for adjustment. The first of them is a transfer of the IGP-M, which in the period was 8/27 significantly higher than ITC amount in this period in the last 12 months and also XQ Factor that has the positive effect to the company. Basically, because of the reduction of the indicators that we have to cite inside they were better and that had a positive effect in our XQ Factor.

Turning to Slide 4. We have our highlights in the EBITDA. You can see in the pie chart to the left, the share of the Distribution segment, 64% in this business, the growth of 20% of Conventional Generation, 12% of Renewable Energy and 4% in Commercialization Services and others. And the performance of the different businesses we see here as distribution segment with the growth of 23.6%, basically, still reflecting the tariff adjustments, and also tariff reviews that we had over 2018 associated to the growth in the energy consumption. And this is a significant result and a positive result for the company in the quarter.

Followed by Conventional Generation, here we had a drop of 6.5%. Pan is going to detail that. But basically, here, we have two nonrecurring effects. The first one is positive. In 2018, there was the effect of Brazil's [ph] agreement. Our HPP in Barra Grande. That was agreement in 2017 that allowed us to have a positive effect in 2019 -- 2018 of BRL17 million. Another nonrecurring effect in 2019 is the increase of investments related to our CPT cause of BRL10 million of investment. Here, basically, we have anticipation of investment considering the high levels of the generation that we had in our TPP.

We did anticipate investments and also we had one-time of investments, and that have affected our cash in BRL10 million. Renewable Generation, there was a drop of 15.7%, that too affects as well. Here, the performance of wind, which is still low in the quarter, just as we had that in the last quarter of 2018. And also, there's a seasonalization effect in our SHPPs, and this effect will be offset over 2019. And a very positive performance in the

Commercialization Services and Other segment with the growth of 165%. We should highlight here the Commercialization with better margins in 2019, and also with a better performance in services.

Now turning to Slide 5, we have our energy sales. As I said, there was an increase in the concession area of below that 1.9%, considering the impact of those two free clients that left us and went to the connect -- direct connection to the basic grade. It was -- by that way, we would have a growth of 2.5%. Also, we had increasing sales in the concession area of 3.2%.

Net of that, in fact, of these two clients, we would have had a growth of 3.8%. The main highlight here is in the residential area with a growth of 8.4%, followed by the commercial area with 5.1%. Basically, here, what explains this high growth is the increasing temperature, especially in January and February of this quarter that allowed us to have a higher consumption of energy. In terms of losses, they are stable vis-a-vis the losses of the prior year 8.884% compared to 9.038% last quarter of 2018 and 8.82% in the first quarter of 2018.

Now turning to Slide 6. We have our hydrological scenario. We see a clear recovery of the scenario, especially, here in the months of April and May. We are reaching a level that is higher in the month of May for the whole Brazilian and IPS system. This is a similar situation in the south region. And you can here have our expectation of the levels of the reservoirs. As you can see, obviously that, that positive expectation -- we have a drop in the stock price. We had a peak in prices in February and we see the curve in a downward trend, and so we were have lower prices here in May.

To our right, we have with the GSF projection now in month -- month of May, this is the first time that we will have the GSF up to then and we were having the secondary energy in the system and the expectation that BSF now for May, after the end of the year in December, we have an average expectation of around 16% in the average of 2019.

Now turning to Slide 7. I turn the floor to Pan, and he's going to talk about the results of the first quarter 2019.

Operator

Excuse me, now I would like to turn the floor to Mr. Pan, and we'll have his presentation in English.

Yuehui Pan {BIO 20609514 <GO>}

Good morning, everyone. So the first quarter of 2019 compared to last year. In terms of the mass revenue we have around 12% of increases and also, there is 2% increase that also occurs, thus we have in the first quarter of 2019, a 1.5 EBITDA [ph] compared to 1.4 in the last year. In terms of Lucro Liquido [ph] we have 36% increase which represents BRL151 million. And then, that's what declining by the first half and then, in fact -- first income EBITDA -- we have around BRL185 million of increase, on audit, we have about

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BRL230 million impact from margin and tariff agreement last year (inaudible) adjustment from the course, we recognized BRL34 million revenue recognition in the income statement.

In terms of PMSO, we have BRL8 million net impact compared to last year, and AVA is about BRL42 million and we have BRL20 million of more income distribution on standard provisions. The adjustment is about the non-regeneration. We have BRL36 million increase compared to last year and that is BRL78 because of seasonality cost and the lower wins in power generation, which remain BRL25 million. And we have the start-up of the (inaudible) no other passive this increase our revenue by BRL13 million.

In the third part is the commercial and salaries and other areas we have BRL25 million increase even from this area we have a pretty margin BRL23 million for the last year and we're (inaudible) not being adjusted. And it is possible that conventional generation allows BRL20 million in April that is because I would say BRL17 million change of the cap rates to last year was BRL17 million of an increase but we don't have that impacted EPS the adjustment of decrease from the last year.

In terms of our color [ph] that is BRL10 million we have this year. And in the fact (inaudible) the financial results contributed BRL87 million that is because of that reduction in the investment of BRL66 million. And then we go to the investments of the company, and in this bar chart we can see that the leverage of company going down every year and came out actually 2.7 ratio of the net debt over that data, that is because that we have without the operation 25% this year (inaudible).

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session, which will be importantly with simultaneous interpreting into English. (Operator Instructions) First question comes from Bruno Varella with Solana Capital.

Q - Bruno Varella

Good morning Estrella, good morning, Pam. I have two questions. The first question has to do with an increase in ADA. Could you -- there was an increase at least year-on-year on ADA at distribution company. I would like to better understand the reason. The second question we saw a very strong deleverage this quarter if you consider the fourth quarter of 2018, 2.7 times EBITDA. I'd like to understand the rationale behind it? What is the vision by year-end, what you consider to be an optimal leverage that you would like to work with close to two times or even lower than two times?

A - Gustavo Estrella {BIO 18109709 <GO>}

Bruno, first of all, actually, if you look at the numbers, there was a significant increase in ADA. Our indicator vis-a-vis net revenue is 0.6 and 0.9. We do see some one-off events compared to 2018 we can see a non-recurring effect of an agreement in 2018 with the

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local authorities, BRL11 million for ADA. But net of the effect, we continue to see a strong impact vis-a-vis increasing in our ADA. And it's a combination of many factors. Firstly, higher tariff numbers for the last year. Added to that, an economy that doesn't show faster recovery signs. We still have high unemployment rates, low payroll, so it all has an impact on our tariff combined to an increase in consumption and showed here a result for residential, which also shows the final increase in electricity bills. So if you combine and put it out altogether, it makes it have an increase of ADA this quarter. And in-house, we already have an action plan, a stronger action plan to fight this upward trend in delinquency. We've increased our number of disconnections among many other initiatives, mainly this is the most important one, the idea is to increase by at least 20%, our volume of connections, so we can fight this increase in delinquency.

In April, we already noticed a drop in this volume of ADA. But certainly, that's a warning sign and we are focusing very heavily to control and lower these ADA indicators. As for deleverage, actually, we did show a stronger leverage in the current quarter. Please bear in mind that you asked this question right in the past. You asked it about atypical variation of our working capital in Q4 2018. We also mentioned that we have an advance -- made some advance some payments that we had for the beginning of the year and we anticipated to December. For this quarter, we have a lower payment volume, which also contributes to lower our leverage in this quarter, 2.7. So it should have been lower at the end of the year, but when compared to 2.7 that we showed now. So basically, this is the main reason behind a stronger drop in the leveraging.

Operator

(Operator Instructions) The next question is from (inaudible). Please go ahead sir.

Q - Analyst

Following up to Bruno's question, what is the biggest target for the end of the year? And in order to meet this net-debt-over-EBITDA, do you plan to increase your payout?

A - Gustavo Estrella {BIO 18109709 <GO>}

First of all, about our net-debt-over-EBITDA ratio, clearly, we have a downward trend in our leverage until the end of the year. We have the only variable in this case would be the level of regulatory actions by year-end. But our expectation today is that with Paulista's tariff adjustment, we'll begin to have a lot of our regulatory assets and the balance is expected to go down, and you can confirm a stronger reduction in our leverage that we're showing right now in the current quarter. For this year, considering the earnings are already disclosed, our payout is 25%. Therefore, the dividend payout expected to have by year-end by December, it will be on top of 25% payout.

Operator

Next question is from Gustavo Fabricio with RPS Capital.

Q - Gustavo Fabricio {BIO 15310190 <GO>}

Good morning Estrella. If you think about our pro forma cash generation around BRL1.3 billion, net of working capital would be a normal -- would be around BRL600 million. So we could see about BRL700 million coming from suppliers. If you think about Q4, I can see that the supplier line was going up. And we also had some CDA of fracs. What about over the year? Should expect to see positive working capital from suppliers FDBA [ph] coming forward, which would be another BRL1 billion approximately cash additionally, how do you see the picture?

A - Gustavo Estrella {BIO 18109709 <GO>}

First of all, we work on those strategy of advanced involved in suppliers and there is some confusion about the working capital numbers. We anticipated payment on top of suppliers, which is higher and now is lower. So to some extent, it should be adjusted. The volume was about the same that you mentioned, simply around BRL800 million. And there is no outlook to have a similar scenario by the end of the year. Clearly, this is assessed on a regular basis by the company and should there be a rationale of financial gains, we might take the necessary arrangements by the year-end, but not now. We can have normal cash generation as we have a normal accounts payable. But like you said, maybe, the main difference in our cash generation will be related to the regulatory access receivables.

If on the one hand, we already are sure of all the amounts already included in the tariff adjustments, particularly Paulista's with some stability and now we start having these amounts. As of now, there's all this uncertainty vis-a-vis new regulatory assets and maybe a more adverse scenario, an increase in ADA. Not to mention GSF hydrological risk. In the recent past, we saw how it has a strong impact in our cash generation. In our current scenario, if you consider GSF, hydrology, the stock price, chances are we can have a volume of regulatory assets to be received by year-end lower than what we have today to do around BRL1.2 billion. And chances are we will be close to half of that by year-end. So once again, it all depends on what the scenario will be by end of the year, particularly, when it comes to new assets, account realizations and what we'll get by year-end.

Q - Gustavo Fabricio {BIO 15310190 <GO>}

Perfect. Just as a follow-up question now about EBITDA. You had a significant increase in EBITDA. It's an offsetting part of the tariff distribution companies. However, when you look at generation, we can see a drop in (inaudible) owing to wind operations and also seasonality. Moving forward, what about the generation EBITDA coming back? I believe it's feasible to have something around or above BRL6 billion this year?

A - Gustavo Estrella {BIO 18109709 <GO>}

I think it's about generation. Generation seems to be very favor in terms of whether the increase. Here, we are talking about the payment stock capacity the rates impacted by inflation, and we expected to grow at least the same amount as the price adjustment. We do have two nonrecurring factors I said in the quarter, which allowed us to have a drop in the EBITDA, but that's not our perspective. These are effects that will no longer happen in the next quarters, and we should go back to our stable EBITDA, considering the characteristics of the business.

Q - Gustavo Fabricio {BIO 15310190 <GO>}

That's great. Thank you.

Operator

(Operator Instructions) Our next question is from Bruno Varella of Solana Capital.

Q - Bruno Varella

Thank you very much for this opportunity. I'm not very clear about the answer to Juliana's [ph] question. Do you have an expectation to increase the payout of the current 25% or not?

A - Gustavo Estrella {BIO 18109709 <GO>}

Well, I think that for this year, well, the payment this year as regarding to the results of 2018, and we have deliberated the payment of 25% of the net income of 2018 and 2019. This is a subject that depends also on the market. Our idea is to rebuild our flow and that's a subject that will be decided in this flow to rebuilding process. Today, the rate we are at, the payment is 25%. But in a possible float redefinition in the market, the subject will be discussed and as soon as we have anything new decided, we'd like know. But today, the decision is 25%.

Q - Bruno Varella

Thank you very much.

Operator

Our next question is from (inaudible)

Q - Analyst

Good morning everyone. Can you comment on the assets you're looking at for possible M&A? What is the company's focus if there is any distribution asset or generation asset that is drawing your attention? Or any of those that are all in the immediate CCEE? Thank you.

A - Gustavo Estrella {BIO 18109709 <GO>}

About M&A. I think what we have discussed about leverage, it's important. The company is in a very comfortable position to participate in growth opportunities in the market. Looking at our DNA. I believe that we do have a very clear growth path related to distribution asset. We show that here, if you look at the distribution results (inaudible) for instance in 2016, we can see that we did have a positive results being delivered. So naturally, considering the scale that we have and expertise that we have in recovering distribution assets, we are a significant player to participate in possible opportunities to growth, if they come ahead.

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We do have some prospective, some possibilities. You talked about CCEE. This is an asset that makes sense for CPFL [ph], especially, because of its material localization. There is a chance of this market being out of the market today. But we certainly will look at it, if it becomes available. In addition to that, really if the market's expectation confirms about other privatizations and if we use our expertise, we will be looking at possible new assets that are in the market and others to address growth in the distribution sector.

Looking at the generation segment. Today, we are the main renewable player. So we are a natural candidate to additional investments in Renewable Generation. Basically, here the investments would be by the means of auction that are made every year, and also, with some possible acquisition movement. Once again, the company also using its expertise and its scale, looks at possible growth opportunities in the renewable energy sector. And in addition to that, in the transmission segment, we have a strategy to invest in what we call niche transmission. These are investments with less transmission lines and assets close to the ones that CPFL already have. This way, we can have some type of synergy in our operations. Here also, the way that we work in the market is the auctions. The expectation for auctions in 2019 is -- the expectations are real. They should happen, and we will analyze that if come to us for the transmission segment. So these are the main possible investment for the company in the coming years

Operator

The next question is from Gustavo Fabricio from RPS Capital.

Q - Gustavo Fabricio {BIO 15310190 <GO>}

Gustavo, if I may, I would like to know more about the offering. You announced a request for NISE, even if I'm not mistaken. Do you have any position about this? And maybe disclose how you intend to go through this offer maybe primary or secondary offering?

A - Gustavo Estrella {BIO 18109709 <GO>}

Like we said, we already had the answer from B3. And now we have some time until October 31. And right now we are precisely assessing and having the company ready to go to market. So that's the time we have, but it is a strong decision at the company about this topic involving several negotiations at the table. One of them is a possible definition for primary or secondary issue or combination of those. But we haven't come to a decision yet. As we'll have the decision, then we will disclose it to the market. But just making it clear, we'll have those terms with (inaudible) and the idea is to go to market. Considering market conditions, our internal conditions and as soon as we make a decision, we'll let you know about it.

Operator

This concludes the question-and-answer session. We'd like to give the floor back to Mr. Gustavo Estrella for the final remarks.

A - Gustavo Estrella {BIO 18109709 <GO>}

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Once again, we thank you all for being with us. We deliver in the first quarter of 2019 very positive earnings, particularly in the distribution sector. It is a highlight of another significant growth. Another important factor is the maintenance of low interest rates with the positive impact on our P&L. When it comes to macroeconomics, we expect the government to manage to address reforms, particularly the pension reform so we can have a more robust upturn in our economy, bringing positive impact to our business and energy consumption. We see that in-house. We've been focusing a lot with an increase in our efficiency, productivity and quality. Indicators are a good evidence of that, and we all know that the next step related both to productivity and quality comes with the implementation of the new technology. So we are focusing very heavily on the deployment of smart grids and other technology so we can have a quantum leap in quality, and that's the outlook for the future.

Another focus is on opportunities to invest. I mentioned before, we expect to have functions this year, generation projects, confirmation projects. The company understands that we can be involved in a very competitive manner in these potential projects, where we can bring even more value to our shareholders. So basically, this is it, a very positive outlook going forward with the high expectation of upturn in our economy, higher consumption and a lot of opportunities to invest. Once again, I thank you all for joining us today. Have a great day.

Operator

This concludes the CPFL Energia Conference Call. Thank you all for joining us. Have a great day.

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