Q3 2015 EARNINGS CALL – CPFL Energia

November, 13 2015

Operator

Welcome to CPFL Energia's Third Quarter 2015 Earnings Results Conference Call. Today we have here with us the Executive Mr. Wilson Ferreira Junior; CEO of CPFL Energia and other officers of the company. This call is being broadcasted simultaneously through the Internet in the website www.cpfl.com.br/ir, where this presentation can be available for download. I would like to inform you that all participants are in listen-only mode during the company's presentation. After the presentation there will be a Q&A session, when further instructions will be provided. (Operator Instructions).

I would like to remind you that this conference call is being recorded. Before proceeding we would like to mention that any forward-looking statements that are made during this conference call related to CPFL Energia's assumptions, management and information currently available on the company or assumptions of the company as well as information currently available.

Forward looking statements are not guarantee of performance because they involve risks, uncertainties and assumptions because they relate to future events and therefore they depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of CPFL Energia and therefore it could lead to results that different materially from those expressed on such forward-looking statements.

Now I'd like to turn the floor over to Mr. Wilson Ferreira Junior. You may proceed sir.

Wilson Ferreira Junior, Chief Executive Officer

Good morning, everyone. Good morning, investors and analysts. I would like to thank you very much for participating on our conference call for the third quarter results.

I would like to start on slide number three. And I will elaborate further in other slides. We had a sales drop in the concession area of discussing all segments. Mostly aggravated by the Industrial segment with 7.4% and then I will refer to the investments, this quarter we invested BRL219 million, totaling almost BRL1 billion year-to-date in the first nine months.

One important highlight is the conclusion of CPFL Piratininga tariff revision in October 2015. And for the first time since we started promoting tariff revisions there was an increase of 5.3% on parcel B. Not only reinstate the improvement on the 4th cycle recognized by indicators that remunerate investments but also in terms of investment that has been acknowledge by ANEEL [ph].

It is also very important to refer to the maintenance of our actions and important portfolios like the Dow Jones Sustainability Emerging Markets Index for the fourth consecutive year also the MSCI Global Sustainability Index Series of Morgan Stanley also for the second consecutive year and there is also some other important highlights of the company because for the 10th consecutive year the company has been ranked among one of the 150 best companies to work for according to Exame Guide 2015.

And even more importantly and also aligned to this new momentum CPFL is among the 20 more innovative companies of Brazil. According to the Best Innovator Award of 2015 and CPFL Energia was selected as the best practice of water risks management in the 2015 edition of the CDP in Latin America. So we are aligned to this new era and CPFL is well acknowledged in the market.
Now I'll go to page four, so we give you some highlights about our sales. We mentioned a drop of 5.6, which is on the top corner of the slide, and we have our revenue in captive market, there was a drop of 5% in the volumes sold. In the free market which is build according to use distribution system that was a drop of 5.9%, but now looking at sales by consumption segment we have a drop of 5.1% in the residential segment, this is the first time that we report such a drop in residential 5.9%, industrial 4.3%, and it's interesting to mention that this is certainly an important factor that reflects the increase in tariffs.

And this has been incorporated by the actual increase that started as of March of this year and this was an extraordinary tariff review which was aggravated by all other tariff. The market price did not change in the third quarter. Therefore, we still have for the industrial segment, this segment is leading our sales followed by the residential segment, and there was 16% coming from the commercial segment.

Another important aspect relates to contracted demand and when we compare this quarter with the same period of 2014 what we see is a more rational utilization of power by clients. So, the peak was reduced but again we are also – the results of a reduction off peak. And this is very crucial one, we consider the use of energy and the tariffs that have higher incidence, higher amounts in the peak volume.

As a result of sales and unlike the usual run of the mill operation and also considering significant suspension of the industrial side which is dropping more significantly. We have Rio Grande do Sul area, which was more affected when compared to the other regions. Therefore, we see a more significant drop coming from concessionaires by region and throughout the country.

In terms of the generation installed capacity, we have -- in the renewable side an increase of 5.7% reaching BRL3,129, so all in all we grew 1.2% this quarter.

On page five, I would like to highlight what happened in the industrial segment, in terms of production and consumption. Industrial production, our accumulated growth rate in the last 12 months, I mean consumption in terms of Brazilian industrial production, there was a very strong correlation of these two events. Industrial consumption, industrial production, there has been a consistent drop since 2013 now reaching 5.3% decrease in industrial consumption whereas in industrial production there was a drop of minus 6.5.

But if we look at the other chart on the right, there was a light reaction in October reaching our lowest position in the past few years, slightly below now it's 70%, it was 76.7% and the average between 2008 [ph] and 2015 is 83.2%. The industrial confidence rate had a slight improvement reaching 67.5%. Looking at the average for the past seven years is 102 and this is somehow reflects all of the other indicators.

On the right side chart, we see all the excessive inventories in the transformation industry. So capital goods as a matter of concern with 56% especially related to infrastructure. Infrastructure was heavily impacted this year, but when you look at the other lines, consumer goods and intermediary goods, we also see the same behavior meaning that our inventory levels are higher than expected.

So there are three instates, all of the other elements that are linked to the drop in industrial consumption, which is lower than industrial production itself. So as we always do, when we look at the full side of the glass, looking at the glass half full here we have some important consideration, currency devaluation, the dollar remain at almost BRL4, BRL3.80[ph] try to think, how can we have a whole set of new opportunities.
So there is an immediate effect on the profitability of the sectors with export coefficient, which is greater than the import coefficient. So this correlation that you see considering the slide generating 6.7% of profitability index coming from the depreciation of the exchange rate of 54% and affecting exports in 54% and we have just 10.4 in terms of cotton production cost. This -- since it comes from other segments that have a relevant stake in our company, we have paper and pulp and food. These are segments that are relevant and they are accounted for 20% of the total of the industry.

These industries in the short run in view of this variation and the exchange rate, they become much more competitive and we've been monitoring some industries also going in the same direction that's why it is important to mention and we see this as something very positive, so in the short run we believe that these two industry sectors should increase their consumption, certainly there are on some setbacks. Because they also have dollar-denominated debt, there are issues related to oil demand, but according to our view and this is something they have already saw in the consumption area that these industries have a likelihood of increasing their volume.

But in the long run the opportunities are more related to increases in imports and the exchange rate works has affected, import has been affected, the chemical and textile industries has been mostly affected, it in our portfolio they account for 18% to 19% and they could have been boosted because there is an ideal capacity that could be build out by the reduction in employees, according to what the chart shows. So this is something for us to monitor and follow up closely and this moves about 40% of the CPFL portfolio. And due to this -- particularly exchange momentum they could be improved.

And now moving to the next slide, we talk about the delinquencies. Delinquencies increased, not in percentage terms, but we see here the stability of this KPI is about 0.85 and the increase in the energy build due to tariff increases that occurred in March and also with our new tariff banner, the amount increased to BRL188 million.

Now looking at Group B, which was more concerning to us, these refer to residential and commercial users. This month alone there was a stagnation, apparently the peak was BRL98 million. With a slight reduction in the indicators related to billing indexes, delinquency over 90 days and that it seems to me that the situation is reaching a level provision and we look at the evolution of our allowance for doubtful accounts with old tariff, the average was BRL20 million per quarter. Looking at the first quarter of 2013, until the current year and due to the tariff increase in this third quarter or in the second and third quarters we achieved this volume going from BRL20 million to BRL33 million.

So this is certainly just a reinstatement that the absolute delinquency levels are not increasing, the average ticket on each delinquency numbers is including that they are already considered here. But the company has really working hard and this is something I already mentioned last quarter but just to give you a number when we look at the recovered revenue in the third quarter of 2014 with 3.18%. Now in the third quarter '15 due to many cuts in other managerial measures to manage delinquency, we had a recovery from 3.88% revenues in 12 months. And this allowed us to operate with allowance for doubtful account level lower when compared to tariff increases.

Now I go to page 8, just to give you some details about our results. It is been a while since we have seen green results both in terms of IFRS reported results as well as the managerial result that incorporates proportional consolidation of generation, consider the consolidation of IFRS and the consolidation of sectorial financial assets and liability.

Now we are referring to this quarter where the Net Revenue in IFRS increased 17.5% reaching BRL 4.7 billion. The reported EBITDA increased 25.7% reaching BRL 1.8 billion and the Net Income increased 188%, reaching BRL 280 million. So, these are the reported amounts. In the proportional consolidation view, which are the most important data to the analysts, the Net Revenue increased 21.9% reaching BRL 4.6 billion. The EBITDA went up to 7.6% reaching BRL 1.7 billion and the Net Income increased 33.8% reaching BRL 305 million.

On the chart below, we have the breakdown of proportional consolidation. Given all of the considerations related to IFRS and sectorial financial assets and liability closed in 2014, GSF and energy purchase from CPFL Geracao and CPFL Renovaveis, the amounts were lower but we will talk about that and what are the solutions in the short run. So, the differences between IFRS and proportional consolidation numbers of EBITDA and net income are very small.

So now, I will break down the numbers of our results on page 9. I will initiate by the EBITDA. So if we look to the tips of the graphics (left and right sides), it is presented the IFRS results numbers. In the middle, we can find the adjusted EBITDA and the variation of regulatory assets, non-recurring and proportional consolidation, which are consequence of business running. It is important to mention the BRL 999 million in the third quarter of '14 and BRL 1.74 billion in the third quarter of 2015.

If we run an evaluation for a segment and conventional generation, we have a significant increase of 21.7%, meaning an additional BRL 58 million. This fact occurred thanks to the seasonality strategy, which you followed last year, we were able to improve the performance of the Epasa. This is our Northeast Thermoelectric plant. We did a substantial work to update the plant, we perform some operating improvements, we did the overall 12,000 hours and we are consuming less fuel to produce power, which affected positively in BRL 3 million and others impacts in BRL 6 million.

Now speaking about distribution, despite the fact that the market is down we were able to grow 8.3% and leading this result we had our Itaipu currency variations, which appears in the bottom part of our accounting and that impacted EBITDA, and there is also an impact coming from the pass through PIS/Cofins of 14 million when we compare this results with the results from the same period of the year before.

Then we will talk more about that 5.3% decrease in energy sales in the concession area, which meant a decrease in EBITDA of BRL 12 million and an increase in PMSO of 6.3% despite of the lower impact when we compare IPCA and IGPM performances (9.5% and 8.4% respectively). So this increase is lower when compared to inflation rate.

Allowance for doubtful debt was 18 million offset by collection actions of BRL 4 million and they are posted in the company's report. Legal and judicial indemnities amounted to BRL 13 million.

Therefore distribution results is positive and mainly lagged by EBITDA in view of the currency variation.

In terms of the renewable generation, CPFL Renovaveis we are speaking about a growth 6.1% or BRL9 million. There are three items that lead the growth: (i) the expenses related to the association with DESA; (ii) the right of insurance indemnity related to the TPP Bio Pedra (we had a problem with the machine but everything was covered by insurance. So we were able to collect from the insurance company); (iii) and the commercial startup of Morro dos Ventos II. So we are 6% better than last year with BRL9 million.

In terms of commercialization, services and holding, we were down by 53.3% or 34 million, mainly caused by the lower PLD. The PLD level was important last year, but if you look at the box down, the low PLD in the third quarter of '14 was BRL 677.00 and in the third quarter BRL 204.00.

So we do not have the burden from the generators. They were exposed to GSF and then they are reduced but on the other hand, we were not able to have more gains, which were higher last year on the seller side.

So we are talking about a positive side on the consolidated, there was an increase of 7.6%.

Now on page 10, we have been talking to you about this ZBB and you have followed the implementation since the beginning. On the left side, we reported the numbers in terms of nominal adjusted figures. We are reporting now based on 3.5% recurring expenses in personnel, material, third parties and others. In real terms, we have been reporting from the very beginning of this operation a drop of 16.5% in our expenses, 1,699 to 1,409. And when we -- in the 12 month comparison there was a 4.5% drop year-on-year.

Therefore, even though we have faced a drop in market, particularly in distribution area, this has been mitigated partially by a decrease in our manageable expenses. This proves the company is in the right direction when it deploys this new measurement since 2011.

Now in the next slide (slide 11), we talk about net income for this quarter. Here, we will analyze the bars in the middle (recurring bars). There was an increase in the adjusted income of the company from BRL 228 million to BRL 305 million, part of it was led by a 33.8% increase in EBITDA or BRL 76 million, I already elaborated on that previously, and a decrease of 7% net financial result of the company amounting to 24 million.

So, here we have a whole set of negative and positive effect. The main positive effects were: the variation of discos' concession financial asset - as a report elaborate on that it gives you more details about Piratininga's periodical tariff review cycle, adding BRL 146 million . There was a restatement of sectorial financial assets and liabilities (which we call CVA) amounting to BRL 39 million. There was arrears of interest and fines and installment payments and delinquency generating a positive effect because we were able to collect fines and monitoring collection amounting to BRL 32 million. Mark-to-market effect, operations under law 4,131, non-cash 33 million.

And on the other hand, we have the negative effects. The main one was the increases in DI rate (interbank deposit rate). More than 70% of our debt is indexed in DI rate. So, on the right hand side of the chart, you see a box showing when the DI rate was 11.6% a year on the third quarter of 2014 and then this rate went up to 14.7% a year on third quarter of 2015. Therefore, it was almost an increase of 30% and this is the main reason of the growing in financial expenses.

We have Itaipu currency variation amounting to BRL 97 million added to the disco’s EBITDA but it is deducted in the last line. This is compensated by sectorial financial assets or revenue and PIS/Cofins on financial revenues in the cash position of the company. The new taxation standard of PIS/Cofins amounting to BRL19 million and other positive effects amounting to BRL10 million.

There are also two other additional events, one being an increase in depreciation and amortization, asset, startup and increase in distribution and increase of income tax and social contributions amounting to BRL 18 million given the general improvement of the company.

Now, I go to page 12 to report on our debt position. We are reporting net debt over EBITDA ratio of 3.46. Following the approach that we have mentioned last month, we highlight the CVA increase. If all the CVA assets, estimated in 1,907 million, is generating cash flow (if you look down below on this chart), we would be running our net debt over EBITDA of three times, which is the target of the company. But, we can observe a recurring adjusted EBITDA of BRL 3,971 billion and a total debt of BRL 1337 billion, which means a net debt/EBITDA ratio of 3.46.

So, the cash balance is been affected because we would have BRL 5.6 billion in cash, if it were not for the significant increase of that -- green part of the chart which is called CVA. We ended 2014 with CVA amounting of BRL 900 million. Then, we reached BRL 1.0 billion on the first quarter, increasing to BRL 1.5 billion on the second quarter and closing the third quarter with BRL 1.9 billion.

The box shows us that from the BRL 1.9 billion of CVA, we will start to recover BRL 475 million through the 4th PTRC of CPFL Piratininga. The new tariff came into force on October 22, and now we will start the restore of our cash balance.

The other slide on page 13, we have a debt profile. There is not relevant change in the profile, which means that 74% is indexed in DI rate. The nominal cost had a slight increase of 12.2% in the quarter and the real cost is around 2.5%.

The important thing to mention is our net cash position in the company BRL 3.7 billion and it covers 1.7 times short-term amortization. So this is a comfortable position. The average tenor of the debt has a cost of -- in the short term 12.4%.

So speaking about the reservoir levels, we expect to end November with 26.5%. This confirms our predictions that we have expressed earlier this year, I mean -- this is even a better number.

This is a good news because all of the rational risks are put outside. If you look at the lower part of the box it has been raining more in the dry season rather than in the wet season in terms of LTA figures. In 2013 we had a 102% of LTA in the year 14.68 and in 2015 we are improving our situation in the last 12 months to 78% in the southeast.

Now if we look at the NIPS, and here we refer to the southeast, because of its contribution, besides we refer to the south, because most of our power plants are in the south and theses affect the cost of GSF in the plant and other secondary things. So, we can see we had a LTA (southeast) of 102% during 2013, 68% during 2014 and now there is a significant improvement to 109% in the dry season reaching 88% in 2015. This is very good and it seems like we will have better days ahead.

On page 15, we are going to make a comparison of the estimated volumes for 2015. As we can see, the top curve represents the first estimate made by ONS. The blue curve is the CPFL curve and we have variations that now are decreasing when we compare the value by ONS. In their estimates for November, there is a decrease of 1.5%. On the other hand, CPFL has been working with the blue curve, and we are estimating that the reduction in consumption in 2015 as compared to '14 is approximately 2%. However, there is a reduction in the differences along the year and this could mean something positive.

Moving now to slide 16, where we'll discuss the outlook, and the outlook here ending in October with 28.8 and those 26 we mentioned a while ago (closing figure for November), you'll see 3 curves in the chart: The blue curve represents 100% of MLT, the yellow curve 80% of MLT, which is even higher than what we had in 2014, and a more likely curve of 90% of MLT, with thermal dispatch of 70.

So, we're monitoring this and this serves to show the following: the dotted red curve in the average from 1997 to 2014, we have the opportunity to close slightly above the average if we have normal curves throughout the summer season, and would get very close to the average or even the 90% of MLT.

So, I'd say this: we have to hope to be close to this curve, that means, this an important reestablishment, because as it occurs, there is no need for further thermal dispatch and the energy price will start to fall, and the price impacts that curbed energy consumption could wear off, and we could see an increase in demand.

On page 17, we're detailing the so-called re-negotiation of the hydrologic risk, with two major events: first, the submission of the provisional presidential decree to the Commission, the rapporteur, the Congress Commission, and the submission and approval at the lower house of congress, it's already been sent to the Senate, read, and we expect, based on schedules of approvals by the Senate, that we'll have it approved by next week.

On the other hand, the reports by the National Agency of the fourth review in the public hearing, so, the proposal in the ACR for production against a GSF of up to 100% upon payment of a premium, so, there're three different conditions there in order to provide greater flexibility and options.

This should obviously give the agents contracted in the ACR different prices, but these three options will make us, we believe, see an important adhesion in the level of the ACR, which in the case of CPFL accounts for most of the contracts of our generators.

So, as we mentioned before, the approved text of the Aneel review and the current text under discussion in the Senate will create conditions, in the schedule of the agency itself, to have these amendments signed by December 14, and the option chosen by December 4.

We are very favorable to what has been presented.

On the other hand, in the ACL, the generator would contract a hedge instrument to mitigate the hydrologic risk, and in this case the voting is not completely reported. It requires further definition of the regulation for contracting reserve energy. This is lacking, it'll be approved here with the new provisional decrees, the agents still await further details to decide for an option in the ACL.

This is not the base case for CPFL, we do have contracts in the ACL, but only a few, less than 10% of all contracts. So, in our case here, what applies (and what's interesting even with an impact on results and cash) is the option we would choose in the ACR.

So, as we said, the next steps: approval by Senate, possibly next week, the complementary regulation for the ACL by the agency, we're working here to analyze and approve internally the options we were given, but we've already expressed our interest in the proposals related to the ACR.

Talking now, on slide 18, of the fourth cycle of Piratininga. Very quickly here, you may see the final result of the tariff review in the box here. I think it's important to see the evolution in regulatory EBITDA below. We started here with a regulatory EBITDA in the third cycle of R$239 million, or R$41 million with inflation adjustment and with the WACC and useful life revision it goes to R$291 million. This would the result the company expects.

However, the company has made significant investments in its grid and has additional investments that add R$132 million to the regulatory EBITDA and, of course, they are deducted by the fully-depreciated assets. The company invested more than the assets that have depreciated and here there's another important improvement recognized by the agency, the so-called inclusion of special obligations. So, we are going from a third-cycle, pro-forma EBITDA of R$291 million to reach R$354 million.

This is what has led Portion B to increase 5.31%, from R$717 million to R$755 million. So, I'd say, we think this is positive, as we had told the market before, and this is the first evidence.

To close our presentation, on pages 19 and 20, just to remind you of our sustainability performance, it's an important theme in an important year, when COP 21 takes place in Paris, now in December, and the company continued to be a component of the Dow Jones Emerging Markets Index for the fourth consecutive year. A total of 92 companies from 14 emerging countries participated, so the list considers the best sustainability performances in the world, which makes us very proud.

At Morgan Stanley, also for the second year in a roll, Morgan Stanley maintains over 500 indexes, including the companies with the highest sustainability standards in their respective industries.

And, finally, four important awards, recognitions that we had: one of the best companies to work at for the 14th consecutive year, the Best Innovator 2015 according to A.T. Kearney and Época Negócios, one of the 20 Most Innovative Companies in Brazil, CPFL is in the ranking, management of water resources, best practices recognized by the Carbon Disclosure Project (CDP), CPFL was elected as having the best management of water resources, and also this theme here in the Impact Awards, which is an association of operators of the SAP system that evaluated success cases in the IT area, and CPFL ranking first with the Group A telemetering project, project Tauron; the program is linked to smart grid, which we have already implemented for Group A, as announced to the market, and we're now moving on to Group B.

These were my initial remarks. My team and I are now available for questions from investors and analysts.

Questions and Answers

Operator

Operator: Ladies and gentlemen, we will now begin the questions and answers session. To pose a question, please press star one. To withdraw your question from the queue, please press star two.

Our first question comes from Marcos Severine with JP Morgan.

Good morning Wilson. I have some questions, the first of which expectations for 2016 based on electricity consumption. This year we saw until November a drop in the market a total of 1.5, residential 0.5, industrial minus 4.1 and commercial on the positive side 1.1.

At the same time, we estimate a drop in the GDP quite strongly of 3%, if we go back to the past 2001 during the rationalization before the GDP dropping less and the consumption dropping around 18% to 20%. Considering that the rationalization was not throughout the year.

When you look at these figures and this level of the decrease of the GDP, if we had the same conditions as in the past, probably it would have been weaker. So my question is haven't we reached maybe the lowest level in the electricity consumption and maybe 2016 will be less consumption as compared to 2015 even if we have a negative GDP; 1.6%, 1.5% these are the figures that the market has been working with.

And my question depending on the second semester of next year and some recovery and even a drop in tariffs is the hydrological scenario is confirmed maybe the commercial segment and the residential segment might have greater consumption, getting as a surprise in the stronger demand in the market than what we see today? That's my first question.

So with GDP, which is negative 3% this year, consumption dropping to 1.5%, so how do you see consumption in 2016 due to that? And my second question, if you allow me is in relation to growth perspectives. I think we have a very important new event which is privatization in the electrical sector, not only in terms of distribution, but also generation, it was not imagined some months ago. When we look forward and we see a situation for states and municipalities which is complicated, maybe 2016 might still be a difficult year and this sector that has a very strong state presence, not only in the federal scope but also in the state scope.

In Rio Grande where you have an important distributor, you have Phase IIIE distribution and GT, Solex, Copel, Somig and so on, so there are number of assets that come to the market and the word privatization is not so sinful any longer and everyone is talking about it.

What you think about it? Do you think we're headed that way? Do you think that we might go into this privatization way? I would like to hear your opinion on that. Thank you.

Wilson Ferreira Junior, Chief Executive Officer

Perfect. Thank you for your questions. First, in relation to the consumption topic, I think that what you think is what we think. We have been working in 2016 slightly in positive terms, I'm talking about flat, 0.4% right now. We believe that it's the same thing what you've mentioned, especially in the residential sector we believe that people are losing a little bit of their comforts to energy management due to the price.

The unit consumption is still the lowest one, the lowest of the lowest is, a record low. We had resumed the same figures of 2001 after the rationalization.1.5 years ago we were slightly below that because people have more appliances at home, they have mobiles, they have high-end televisions and computers which is equipment they did not have before. So we're talking about rationalization and time of use of these pieces of equipment and obviously that impacted by the price.

So as we have an improvement in hydrology and the reduction in tariff flags possibly people will resume their previous behavior, because they do have more equipment at home than they had in the past. So, obviously this will happen. On the other side you see in the industry, if you look at the scenario of the drop in production that we have just shown considering the power demand behavior, there is only a rationalization. The demand continues to grow with new ventures. Obviously, the increase is not so big, but we have seen in addition to what I would call the notable cases on average what is happening is only rationalization from the peak to off peak. So we are trying to improve the process and I believe the industry.

And this is why I wanted to mention 40% of the portfolio here has a perspective today that is different from what was six months ago because of the exchange rate change. Obviously an improvement in the residential segment and something in the industrial segment. If we had some kind of public policy which will mitigate or minimize the unemployment conditions, the commercial sector will also accompany that.

Now due to the GDP perspective, we have been working where the GDP, not a 3% like you mentioned, it's much lower of 1.5% drop off next year, but we have not seen a drop in energy as would be expected.

So just to wrap up, our expectation is that, yes, we will be slightly positive next year and we might have an upside considering a change in climate which is not priced here, but can surprise us positively.

On the other hand in relation to privatization – and this is a personal opinion – I agree with you. I think, because of the price, it is affecting not only the federal government but also the state government and it is easy to understand. I was talking to journalists the other day, what people have cut are things that we call that are superfluous and excess, usually things that have taxes included. The essential things especially food, the results that come from recent policies do not have a burden or at least the taxation was reduced. That is why the states feel more whenever you have this kind of decrease, which has a greater impact. It seems the economy has recorded a decrease of 3% but the state budget has decrease by 6% because the products that have lower consumption were the ones that had a higher taxation.

So obviously there is very little to be done on the state. Over time, I think they have become more efficient. It is always possible just like companies. Costs are just like nails. You've got to pay attention and always cut them, but I'm sure that some states now that they have renewed their concessions will consider and they should consider the possibility of privatization.

Now there is a concession that was renewed by 30 years, it could be operated in a more efficient way and the state can not only has a short-term solution for this cash, but also a performance improvement and collect more taxes. This is what happened to most of the states that privatized.

And since this is not a forbidden word anymore and maybe this is one of the few solutions in the short-term to face this decrease in the budget, I'm pretty sure that with the leadership of Eletrobras and with the sale or renewal of these concessions, of these 29 power plants, I think this is a road that will be chosen.

And it is important to monitor that because of its improvements and the attractiveness for foreign investors for these assets because on the other hand, the high exchange rate does favor the acquisition of these assets. So there will be more people interested, even foreigners interested in these assets as of now. So I do think this is a scenario that should be considered almost as a basic one right now.

Marcos Severine, Analyst

You are right, we have the exchange rate to complete this equation. Thank you very much, Wilson.

Wilson Ferreira Junior, Chief Executive Officer

Thank you.

Operator

Our next question Kaique Vasconcellos, Citibank.

Kaique Vasconcellos, Analyst

Good morning, everyone. Thank you for the call. We saw leverage dropping to 3.5x net debt/ EBITDA, but there will be a future drop but we will have better results in the renewables and CVAs. But considering the market nowadays and last year to keep cash the company had dividends in the second half. What is the payout for this year?

Do you have any visibility for that or will you wait GSF and hydrology questions? Can you address these two points. Thank you.

Wilson Ferreira Junior, Chief Executive Officer

Thank you, Kaique for your question. Just to make it clear, at the beginning of the year, it's not that we did not pay, we paid in stock dividends, we still offered shareholders the possibility of a bigger payout. Obviously, we're coming to the end of the cycle and I think the results of this quarter shows this. It seems that we have come to the limit of the CVA commitment. It will reverse now. That's the trend and the cash position of the company will improve maybe in one year.

So which is important to have this reversal sign. As you mentioned quite well, we do have the hydrology issue. We have been studying and we will address that in the Board in future meetings. The recommendation of the company is still very cautious waiting for these two events.

The GSF event is very important of improving the results of the generator in consolidated terms for CPFL Energia. We will evaluate this improvement and this decision based on the options that we have had. This will take both in next days. So this is part of the agenda of the Board. We believe that we will be able to share a decision on dividends and how it is going to be done as of early next year.

Kaique Vasconcellos, Analyst

Thank you very much.

Operator

Our next question Arlindo de Carvalho, Credit Suisse.

Vinicius Canheu, Analyst

Actually it's Vinicius Canheu who is speaking. Wilson my question has to do with the two previous ones. We are seeing the auction of the concessions that were not renewed – not exactly CPFL's core business – and seeing this is an acquisition opportunity that could be interesting, ANEEL is not indicating the renewals for all distributors, there are many companies with complicated financial situation.

And now you are at a point that we cannot say that it is a calm period because the debt shows that and the stock dividend operation, but you're more in a defensive position than you were in the past.

But there are also opportunities, I would like to know about the company's planning, in terms of when the market was bullish there were fewer opportunities for expansion and with low success and now we a bearish market and opportunities are coming by. So how do you think about offsetting the balance of the company, leverage issue, paying dividends, will there be an increase in capital will all of these opportunities in the future? What is the rationale nowadays? Will you keep this defensive posture stance or will these opportunities really allow a more aggressive position of the company?

Wilson Ferreira Junior, Chief Executive Officer

Vinicius, right now, I think the year was important because of that. This is a characteristic of the company's financial discipline. So we act in a preventive way in terms of pre-funding actions. That's why we have a comfortable situation of liquidity even though there is a stress on the cash. We would submit to that and so were other distributors in terms of CVA and so on.

What we've seen right now is a reversal of this. It is the beginning of a reversal process that will happen in our evaluation in order to reestablish the cash position in a period of more than one year.

On the other hand, you are right. We do imagine that there is a set of players that were not able to resist as CPFL did and opportunities will come by. We have this characteristic of discipline to create value. So obviously, that should be prudent and lead to a healthy limit in leverage in this moment of the economy, which is not one of the best periods we had. We are always assessing things along the lines of the businesses we are focused on, on distribution, generation, mainly renewable, and all of these opportunities that they will have to allow not only the creation of value and this has always been our only indicator, but if they're made possible they will be made possible according to leverage limits that are below 3.5 times.

We always work and we've never hide that from the market. We believe that to operate in a leveraged way, in a cautious way, this creates value for the company and tax shield that these operations allow us, but in a way that we have control of it. So the Company operating the 3.5 times the EBITDA, we are detached from this position today and the reason is well known: the use of CVA and something that we do not mention, but it gives more space for leverage is the reversal of GSF. These values and options we've and were recognized through the month of December and we have been monitoring that. There is a set of operations that can be done and we should highlight the following.

There are transactions that can be done and can even improve things. It is said that it's not a leveraged Company in the consolidated but it could bring a benefit to the Company. We will be cautious because we believe that to grow as the way of creating value for the company, we are permanently assessing that. We have a specialized area inside the company that assesses all that, but yes we will keep being cautious, like we did throughout the year. We're still going through -- maybe we're in the middle of this crisis, maybe a little bit beyond the middle. So we still need to be cautious and to analyze and be careful with the financial situation of the Company.

Vinícius Canheu, Analyst

Okay. You're very clear. Thank you.

Operator

Our next question Miguel Rodrigues, Morgan Stanley.

Miguel Rodrigues, Analyst

Good morning, Wilson. I would like you to mention the process of discos renewal for the Company and for the players in general. Would you also mention the parameters established by ANEEL at what level do you expect these parameters to encourage the consolidation process? So on this topic, could you mention the strategy of the Company throughout this process. How do you plan to position yourselves, what kind of assets will you prioritize, large concessions or more concessions of a smaller size and also the geographical issues. Thank you.

Wilson Ferreira Junior, Chief Executive Officer

Hello, Miguel. I will give the floor now to Helio Puttini that is Director of Regulatory Issues in Distribution. He has been here with us in all in events related to the evolution of the proposal of the agency. I will ask him to get his comments and then I will comment on your question.

Helio Puttini, Director of Regulatory Issues

Good morning. The process was addressed in a public hearing by ANEEL. There were two phases the referendary director stated several possibilities to discuss this amendment and for us in our opinion, it brings a lot of progress of the neutrality of Parcel A. There are rules of governance that reinforce the governance of the contract and we are in the final period. We are now being asked to sign the contract. I think we're going to sign it by December 8. We have received and they have already been published and we are receiving these invitations to sign -- the perspective is that in the next 30 days, all of the concession contracts will be signed.

In our view, the minutes made available are very positive considering the strong interaction ANEEL and the Ministry provided in defining the minutes of the amendment.

Wilson Ferreira Junior, Chief Executive Officer

It is important to mention, in terms of the indicators you have mentioned of the service quality (SAIDI/SAIFI) and also of the indicators for financial health - in both of them our situation is quite comfortable. Only one of the concessionaries in the improvement of SAIDI/SAIFI is now below or theoretically above the limited established to take place in five years, but that is a very small deviation. We do believe that we will overcome this, in terms of quality and like I said there is only one issue in all those five concessionaries. In one of them, we do have challenges and we have five years to solve that.

So definitely nothing concerns us in terms of quality, but in terms of the financial health indicator even less. According to our evaluation, none of them have an additional challenge as to what the Company would do regardless of this rule. So we are feeling quite comfortable here. We were naturally evaluating the quality demands for the Company and these concessionaries are already a benchmark by the agency in terms of technical and operational quality and financial performance.

In terms of the speculation that you mentioned of the concessions and the possibilities. I always said that the Company has been considering on its strategy growth in distribution the concessions that have greater difference, that create more value, which are the small concessions close to the areas of concessions that we already own. Obviously, there are some options. The small concessionary within our concessionary, there are mid-size concessionaries also around that. If we analyze in terms of preference, according to the work that will be done and the results that can be offered and the time it will take place, these are the best ones. Today, the model that I would say is using information system and so on, the geographical issues is variable. I believe it's good, but it's not something that will hinder things if the concessionary does not have a good performance. Our preference is for the size and obviously, if not contiguous, being near our area, this is the second point. Out of the forty concessions that are being renewed 42 concessions, I think now that was mentioned here in December, there will be this option and as of this point, according to what we said before in one of the answers in relation to an option or that the government makes and in this case, it's the municipality in terms of privatization, we will pay attention to that and we will be able to assess carefully these preferences.

Obviously, the smaller ones are the ones closed with or inside are the best ones and the bigger ones, and the ones close to them are the second option and we have to evaluate all the others. We're paying attention to everything.

Miguel Rodrigues, Analyst

Thank you very much for your answers.

Operator: Our next question comes from Pedro Manfredini with Itaú BBA.

Mr. Manfredini: Good morning, Wilson, good morning everyone. My question is also regarding the growth strategy, thinking in terms of M&A, so greenfield, whether there are some other options that may arise for CPFL in different areas, you've mentioned a lot about the leverage issue and how it limits you making certain types of acquisitions in the short term or grow in the short term, but then CPFL could also partner with someone with a smaller stake or a majority stake, but always thinking of joining a partner for a possible consortium. We've seen you doing it in the past.

Is there any chance of that? Have you considered this possibility for an eventual opportunity in generation or distribution? This would be my first question.

My second question is: we are seeing some big companies in the industry selling non-core assets to gain some short-term cash relief, to maybe carry out another more tactically relevant acquisition that makes more sense.

Can we also expect that from CPFL? I mean, targeting some asset that might make more sense tactically to the company? Could you also sell some assets, for instance, generation ones, to raise funds to do an acquisition of this nature? Is it also a possibility?

I think those are the two things… the two ways of my question about growth. Thank you.

Mr. Wilson Ferreira: Well, let me start from you last question. Of course, selling quality assets, for instance, with generation assets that you can guarantee your surplus value, it's obviously an option. It's not the company's first choice, but if we received an exceptional offer for an asset in which we could realize the entire value we'd have over time, we would obviously consider the proposal.

Now, to answer your question considering if this were a reality – and let me make it clear that it currently isn't, but let me also make it clear that it would be something we would certainly consider as a possibility as a company, to go this way, as this would give us a new perspective to create value after realizing the value of the first transaction – as always, in the area of generation, we always have partners for greenfield projects, and that's a company strategy to share risks.

In term of… so, it's something we'd continue to do, we don't have any type of… in certain assets, such as, for instance, in the case of Serra da Mesa, we have a partner there, which is a government-owned partner, the acquisition was carried out together and we're there, we have excellent generation with our partner. So, this could undoubtedly be considered for a bigger acquisition, we could easily associate with someone else provided, of course, there are unique capacities enabling the partnership.

We don't have, maybe differently from other companies, any type of prejudice in this regard. We have partners that are self-producers, we have government-owned partners, both by the state and federal governments, I mean, the company is obviously open to partner with companies that enable us to operate and maintain the asset in the best conditions, and it'll certainly consider this alternative, as it has always done.

So, like I said, I think there's a great set of… and they will arise from renovations of concessions, a large volume of alternatives. So, to make it work, if we have a perspective of creating value and making it work we can give up some non-core assets of the company and use these proceeds to take the second step, I think that's a strategy the company will consider and if the operation is viable, it'll do it.

Mr. Manfredini: Great. And my last question, now unrelated to M&A, looking at distributors, have you noticed in recent months any reduction of 'take or pay' of industrial clients in you TUSD?

Is this something that is already... I imagine it's something you've negotiated with some large clients in your concession areas. If you could just shed some light on whether this is already going on or not, it'd be great.

Mr. Wilson Ferreira: Pedro, what we've seen is what we've reported in our report. I think there's a reduction of certain… shifts of operation and there's some, let's say, preference, an operation targeting at removing energy from the final consumer, which is more expensive, and migrate inside.

There's a change in profile with regards to leaving the blue tariff and moving into the green one.

Is that it? Is that what we've been saying?

CPFL: Yes, from blue to green.

Mr. Wilson Ferreira: From blue to green.

Of the entire demand, it continues to grow softly, but from demand at the final consumer, it has been decreasing and inside demand has been increasing. Exactly like we've shown in the presentation we did. There're more details in the report.

Mr. Manfredini: OK, perfect Wilson. Thank you.

Operator: Our next question comes from Marcelo Sá with Banco UBS.

Mr. Sá: Regarding the A-1 auction, I was wondering if you could add some color as to what you think of the price that was set at R$149.00, whether you consider it high, low.

If you could shed some light on your expectations for energy demand in this auction and for energy prices for 2016.

And in the 3-year contract, 3-5 years, what do you expect in terms of price? Thank you.

Mr. Wilson Ferreira: Well, Marcelo, I'll ask Daniel, our Chief Operations Officer at the commercialization company.

Mr. Daniel: Regarding your first question, the A-1 auction price is lower than current market prices, which could limit the participation of some players in the auction.

Eventually some agents that have surplus energy in their portfolio may decide to sell at this price, expecting a possible decline in prices within the auction timespan.

So, this is our expectation in this respect.

Mr. Wilson Ferreira: Which is of 3 years.

Mr. Daniel: Which is of 3 years, this volume contract, you have other products, availability and price, which are unique.

I'm sorry, I forgot your second question, what was it again?

Mr. Sá: What volume of demand do you expect for the energy auction and your price expectations for 2016 and going forward.

Mr. Daniel: OK, in terms of demand for the auction, we are looking at something around 1,000 average-MW, around that. In terms of prices for 2016, for the free market we're considering around R$160.00 per MWh. For the auction, we haven't built yet an expectation of the auction's result specifically.

Mr. Sá: Great. How about for the long term?

Mr. Daniel: Prices should not fall much below this level. When you consider 2017 and 2018 onwards, prices range around R$155.00 and R$150.00, which should be maintained in the long run.

Mr. Sá: Excellent, thanks.

Operator: Our next question comes from Carolina Carneiro with Santander.

Ms. Carneiro: Good morning everyone. We know there're many variables to be taken into account, but I'd like to know if you expect any possible tariff increase or your expectation for tariffs in 2016, especially in the case of Paulista. Thank you.

Mr. Wilson Ferreira: In the case of Paulista, for 2016, the only scheduled increase is the annual tariff adjustment, no wait, and the tariff review.

So, I'd say, it's basically ordinary. We don't expect any surprises. Of course, as is the case of Piratininga and the other companies, the most important impact on these concessionaires will be the incorporation of the regulatory asset in the CVA.

That is a pressure for investment, but also the incorporation of these quotas tries to mitigate some part of it, and if there's an improvement in the hydrologic scenario, since for Paulista it is already in April, you could be looking at a reduction in dynamic pricing.

Ms. Carneiro: Right, I just wanted to get an idea of whether you already have an estimate for this tariff increase, the adjustment.

Mr. Wilson Ferreira: Not, at this moment we don't.

Ms. Carneiro: OK, so, a second question, if I may, you mentioned some preventive measures, which helped you stop losses, even PDA this quarter.

I'd like to know if, for 2016, we can expect these actions to be maintained as to mitigate, to try to mitigate this possible increase in losses that we expect due to the macroeconomic environment. Just to get an idea of PMSO levels next year. Thank you.

Mr. Wilson Ferreira: No, you can expect that, indeed. PDA management is a priority at the company. Our experience shows that if you, especially in moments like this, to expedite actions like this… just to give you an idea, I don't know if that's in the report, but the amount… I made a reference to it on page, let me find here, on page 7, to the 3.18% that we have recovered of revenue in 2014 and the 3.88% in 2015.

The difference we'd have if we hadn't been so effective, just these 0.7 p.p. of revenue, would total 150 million in the quarter. An extra 50 million per month.

This is just to help show you why this is a priority theme here, you can expect additional costs in this respect of around 4-5 million each quarter, with the benefit of preventing additional delinquency of around R$150 million.

It makes a lot of sense for the company, it's a cost that pays off really fast.

Ms. Carneiro: Of course, thank you.

Operator: We are now ending the questions and answers session. I'd like to offer the floor back to Mr. Wilson Ferreira Junior for his final remarks.

Mr. Wilson Ferreira: Very well, I'd like to thank you once again for participating in our conference call. I'd like to highlight a few points just to summarize the moment we're in.

I think that, during the presentations early this year, I mentioned we had a significant regulatory agenda for the year, which included dynamic pricing and its value restatement, the extraordinary tariff review, the improvement in conditions for the fourth-cycle tariff review and, on the other hand, as you may remember, some trend related to accounting from 2014, two pending installments, and in this environment the evolution in dealing with renewal of distribution concessions, for which granting was being discussed for some time, and finally the GSF.

What I'd like to say to you (I saw from one of your reports), I think we're reaching the end of the year with quite an adverse outlook going forward. I believe that in the regulatory aspect, with the possible conclusion next week of the GSF discussion, the industry will receive an upgrade in regulatory terms.

Every action (of course not always within the timeframe we'd like, but in the possible timeframe) in which we are engaged has an impact on consumers, and this has to be managed properly, but I want to say to you that, whether the government through its ministries, whether Aneel through its professionals, are facing this theme responsibly and diligently.

So, I'm happy to know that we're starting next year with these issues behind us.

And this creates possibilities. The outlook about which I believe you are concerned is the market outlook. Our expectation, considering the worst-case scenarios for the economy, we believe, could be positively surprising. On the one hand, because we already have very low levels of specific or unit consumption, which shows energy use is very efficient, and on the other hand, because there are some sectors of economy that are revising their outlook upward, even forecasting growth, due to the new foreign exchange scenario.

I think it's also important to mention the outlook we discussed in the conference call for opportunities. Because a company such as ours, with a great portfolio of assets, a solid strategy and etc. has always had financial discipline.

We're maintaining that. Of course, it's in our interest and we consider projects to add value. But we'll always proceed carefully at the right time and with the right financial discipline to create value over time, as it is usual for a company, a holding company such as ours, which prides itself in taking every step, every operation, in sharing not only financial discipline, but also the perspective to create value.

So, we'll be cautious, but we believe the conclusion of the regulatory discussion, the way the company managed, on the one hand, to adequately manage its financial costs, and on the other hand adequately manage its financial commitments and leverage, we could be considered a player that will have opportunities to create value and to grow next year.

We'll have to wait for the year to start, we obviously have an outlook that, given this scenario of political uncertainty, we have to act responsibly and think of the country first, until we regain, as businessmen, as workers, as regulators and as Brazilians, the outlook the country deserves.

So, I think the company will be well positioned for these movements.

Thank you once again for listening.

Operator: This thus concludes CPFL Energia's audio conference call. Thank you for listening and have a good day.