Conference Call
CPFL Energia
Fourth Quarter 2017 Results
March 28, 2018

Operator: Good morning and thank you for waiting. Welcome to CPFL ENERGIA'S fourth quarter 2017 earnings conference call.

Today we have with us **Andre Dorf**, CEO of CPFL Energia, **Gustavo Estrella**, Chief Financial and Investor Relations Officer, and other company executives.

The presentation is available for download on the Investor Relations website of CPFL Energia, at www.cpfl.com.br/ri

We inform you that during the presentation all participants will be on listen-only mode and, soon afterwards, we will start the question and answer session, when further instructions will be given. If you need any assistance during the conference call, please dial star zero to request assistance from the operator. Note that this conference call is being recorded.

Before proceeding, we would like to clarify that any statement made during this conference call regarding the business prospects of CPFL ENERGIA and its operating and financial projections and targets are beliefs and assumptions of the Company's management and based on currently available information. Forward-looking statements are not a guarantee of future performance. These involve risks, uncertainties and assumptions since they refer to future events and, therefore, depend on circumstances that may or may not occur. Investors must understand that general economic conditions, industry conditions and other operating factors may affect the future performance of CPFL ENERGIA and cause its results to differ materially from those expressed in such forward-looking statements.

Now we would like to turn the presentation over to **Mr. Andre Dorf**. **Mr. Dorf**, you may proceed.

Andre Dorf: Thank you and welcome to another earnings conference call. Today we will discuss the results of the fourth quarter of 2017 and also the final numbers for the year as a whole. So, as usual, we have a brief presentation here and then we will answer your questions.

Starting on slide 3, we have the highlights for 2017. The first highlight is related to the average load in our concession areas, excluding RGE Sul since it was integrated to the group in November 2016, so to make a fair comparison we excluded it from this analysis. Our average load in the concession areas increased 2.2% throughout 2017. We will see more details on this during the presentation.

We had a busy year here at CPFL, we went through an ownership transition, had some organizational initiatives related to the integration of RGE Sul, grouping of concessions. Even so, our team was highly focused on the operating aspects and on delivering results during the year. As a result, we had an increase of almost 40% in Net Operating Revenue and nearly 18% in EBITDA in the period.

It was also an intense year in terms of investments. In the fourth quarter alone, investments totaled R$700 million, and more than R$2,600 million over 2017. This was a record investment in the company’s history.

Our net debt remained comfortable, we maintained the same financial discipline and thus recorded, at the year-end, a leverage ratio of 3.2 times EBITDA. We are continuing the company's deleveraging trend.

As mentioned, we had the integration of RGE Sul, a company acquired in 2016, and with regard to systems, teams, operating practices, the company is already fully integrated to the CPFL group.

The next item is the grouping of concessions. We grouped 5 concessions with permission from the Brazilian Electricity Regulatory Agency (Aneel) and now we have a single concession called CPFL Santa Cruz. This brings operational benefits and efficiency gains for the group.

During the fourth quarter we also had the public tender for the acquisition of shares, the Tag Along offering for CPFL Energia, with the auction held on November 30, when State Grid became the owner of almost 95% of CPFL Energia’s shares.

And there are some other important issues in the sector that took hold of the fourth quarter agenda, some of which are still on the agenda today. The topic of the Generation Scaling Factor (GSF) for the free market. So, this is an issue that needs to be resolved, perhaps the last major regulatory issue to be addressed.

The privatization of Eletrobrás, here I think it's worth highlighting the two major chapters, the sale of six distributors in the North and Northeast, and the democratization of Eletrobrás' capital, as was discussed in the Congress.

We also had important discussions with the regulatory agency on the regulatory WACC. ANEEL's reasonable, sensible and balanced decision meant that we remained with 8.09% of WACC, which is a very positive conclusion of this issue for all. All investors in the sector, companies, the regulatory body's credibility – everyone stood to win from this decision.

And we also have a bill, resulting from Public Consultation 33, aimed at modernizing the regulatory environment, to modernize the energy sector's regulatory framework itself, taking into account the recent changes related to technology, distributed generation, renewable energies and other social and technological changes around the electricity sector. So, this is an important issue for the future of the sector and which should be discussed over the coming months.

On the next slide, here we have some highlights for the quarter and the year, starting with the pie chart to the left. The distribution of EBITDA in the fourth quarter is shown here. So, an EBITDA totaling almost R$1.4 billion, of which 49% came from energy distribution. So the distribution business was responsible for almost half of the fourth quarter EBITDA, followed by renewable generation, conventional generation and trading and other services, with 3%.

Moving to the charts, starting from the top right, we notice a very significant evolution in EBITDA from distribution, here also arising from the integration of RGE Sul, as well as the market recovery itself. Thus, in the year we had a 21% growth in EBITDA from distribution, amounting to almost R$400 million.

In conventional generation, growth was 8% in the year, and in renewables 23%, so if we add up conventional and renewables we have about R$300 million more in EBITDA gains. Therefore, evenly distributed across the businesses, and in trading, services and others, we also had significant growth, over 17% year-on-year.

The message in this slide is that we had operational improvements, market recovery and EBITDA gains in all of the company's businesses. It wasn't a recovery or one-off EBITDA gain in any one business.

On the next slide, page 5, we talk about the behavior of the energy distribution market. So, starting from the qualitative chart here, we have an increase of 8.7% in sales in the concession areas during the quarter, although highly influenced by the integration of RGE Sul. Excluding RGE Sul, this growth would have been (or was) 4.8%, which is also a significant increase.

And we continued on the path of improvement in technical and non-technical losses at the company. Losses in the fourth quarter stood at 8.81%, relatively better than in previous quarters.

Looking at the column chart on the right, we have the load in the concession area without RGE Sul. Load increased by 5.4%.

If we go to the lower-mid chart, we see sales in the same period and also without RGE Sul. Sales compared here with the indicator are very close to the load measured in the concession area, of 4.8%. And on the chart to the right, we see that all consumption classes registered recovery and growth throughout the period.

I’d highlight the industrial class, with 5.6% growth. It’s the industrial class that drives the economy. So we can notice significant recovery in the fourth quarter.

Well, on page 6 we talk about the same indicators, but now for the year 2017. Starting from the middle chart (sales in the concession area without RGE Sul’s area), we recorded growth of 2.1% and on the chart to the right we can follow the growth of consumption segments throughout 2017, and here all of them show recovery after a few years of decline. The residential and industrial segments also deserve mention.

The pie chart on the bottom left shows our market profile, so the breakdown here is the distribution of our sales in 2017. The industrial segment accounted for almost 40% of our market, followed by residential with almost 30%, and then commercial and other segments such as rural, municipal governments and other classes.

In the chart on the right we compare our performance with other regions. So, looking at the numbers, we had 2.1% of sales in our concession areas versus sales in Brazil as a whole, which grew 0.8%, therefore our region performed better.

In comparison with the Southeast, we had the same 2.1% against 0.3%, and our operations in Rio Grande do Sul saw 2.6% growth, compared to 3% in the South region.

The next slide, number 7, gives a glimpse of the behavior of defaults and AFDA. Allowance for doubtful accounts as a percentage of gross revenue maintained its downward trend. If we look at the chart above, we had a peak in the second quarter of 2016, when the allowance corresponded to 0.9% of gross revenue, and now in fourth quarter last year, it was 0.57%, returning to the historical average.

Obviously, this did not come by freely. The company has been making huge financial and operating efforts to combat default and frauds.

If we look at the bar chart at the bottom right, at our billing initiatives, one of them is energy disconnection and we still had a number far above what is desirable for this kind of activity. We had 407,000 disconnections in the quarter, and we maintained this number throughout the first quarter of 2018 as well. So, there's no respite here regarding collections initiatives at the moment.

In the chart to the left, we see the total bills overdue 90 days as a percentage of gross revenue. This too has improved, returning to historical levels.

On the next page we show some indicators related to the generation business. GSF recorded in 2017 – and here I mentioned that GSF remains an issue that needs to be solved, especially in the free market – but the fact is that we had a high GSF in 2017, of almost 21%.

We also had a challenging year for wind power generation, down 11% regarding P50. In our case we had two main factors for this result: The first was wind speed below expected in some of our regions; and, second, the unavailability in some equipment due to the substitution of an important supplier of operation and maintenance activities of certain wind farms.

This replacement resulted in the unavailability of some machines and also contributed to this negative result in wind power generation.

On the graph below we see the evolution of Differences Settlement Price (PLD), and I make the same observation as from previous calls, about high volatility in PLD, and this continues in 2018, especially in the last few days we have experienced a lot of volatility.

Installed capacity, on the chart to the right, saw a slight increase here, mainly due to the rise in renewable generation, and on the graphs below we see the reservoir levels. This was a very critical topic in the second half of last year, but rainfall recovered in recent months.

The message here is that today the average reservoir level stands above 40% in the National Interconnected System, still below the historical average of around 60%, but already higher than in the main critical years of this decade. As such, recovery ceased to be a critical issue from the viewpoint of supply in the short term.

Very well. On the following pages we deal with the results and for this I pass the call over to Gustavo Estrella, the group's CFO.

Mr. Gustavo: On page 9 we show the results for the fourth quarter of 2017. Overall very positive results, whether operational, or EBITDA, with an expansion of 36% to R$1,366 million. Also on the last line, net income, with a 262% increase compared to 2016 for net income of R$498 million.

When we see here the main effects broken down by each business of the group, we start with distribution, which had the biggest variation, of R$296 million, we start with the biggest effect that is precisely due to market growth. We already see the market growing above 4%, and also the effect of tariff adjustments at the companies during the year. This brought additional R$118 million to us.

We also have the effect of consolidation of RGE Sul. We acquired the company in November 2016, and in this quarter we started full consolidation in the three months of the quarter, bringing a positive effect of R$83 million.

We also had the recognition of the valuation report on CPFL Paulista's remuneration base. This brought an effect confirmed now at the start of this year, retroactive to December 2017, a positive effect of R$63 million in the results of CPFL Paulista, and also a variation basically of the inflation index on the financial asset of the concession, the correction pegged to the IPCA. We had a higher IPCA in the quarter in 2017 than in the quarter in 2016, therefore, a positive effect of R$56 million in the group's results.

On the opposite direction, there was an effect in the growth of the company's operating expenses, of R$89 million. Here basically an effect also arising from inflation by contractual adjustments and also from the collective bargaining agreements for expenses related to personnel, which increased R$20 million.

We also recognized a provision for contingencies, which were mainly labor-related, in the amount of R$30 million in December 2017, some carry over of machinery and line maintenance from previous years that we executed throughout 2017, with an impact of R$15 million in the group's results in this quarter.

Personnel expenses were up R$3 million, due mainly to some terminations we carried out in 2017, obviously with a positive effect of reduction in personnel costs starting in 2018. Also a process closely tied to the tariff adjustment process, shown here is an increase in our Capex, and as Andre commented, it is the highest Capex in the company's history, and it comes linked to a write-off of assets, assets still operating, in this quarter with an impact of R$6 million.

Moving to renewable generation, there was a positive variation of R$65 million, so we had a provision in 2016, or a write-off, that we didn't have in 2017. This write-off, this variation is R$48 million positive. And the operational startup of ACL wind farms added R$27 million to the fourth quarter results.

In conventional generation, I'd say that this is basically a seasonal effect in this quarter, of the Generation Scaling Factor (GSF), we have little exposure to the GSF in our results. Specifically in this quarter we had a negative variation of R$25 million. When we move to the variation in the year, comparing 2016 and 2017, this variation is virtually nonexistent.

Complementing here in the result of the last line, namely net income, we have a positive effect from financial results, greatly influenced by the interest rate reduction, which brought us a reduction of R$184 million in financial expenses in the fourth quarter.

In contrast, we also had the consolidation of the results of RGE Sul, in comparison this quarter also brought a positive effect, also due to the interest rate variation, of R$20 million, but obviously with an increase in the debt level due to the acquisition of the company, which resulted in an additional financial expense of R$34 million.

Moving on to slide 10, now talking about the results of 2017, also in the same line of the fourth quarter's results, a very positive result, with EBITDA growing by almost 18% and net income by 41%.

Among the key highlights, EBITDA from the distribution segment grew R$390 million. The major variation here is exactly the positive effect from RGE Sul, of almost R$300 million in 2017 compared to 2016. Obviously in 2016 we only had 2 months of EBITDA from the company and now we have 12 months, but it is worth noting the addition to results from this company when we look at 2016 versus 2017, in the same 12-month basis, we then close RGE Sul with an EBITDA of R$335 million.

We also have a very positive effect of market growth. In the year we had market growth of around 2%, but a significant increase in the tariff adjustment transfers throughout 2017 which brought a combined effect of a R$256 million growth in our results.

The exchange variation at Itaipu, which is canceled by the result in the last line, plus a positive effect in EBITDA of R$36 million, which we return in the financial results.

The AFDA too, I think Andre has shown here, I mean, there is an important evolution in the group's anti-default program, so a reduction in our AFDA of R$36 million in relation to 2016 is very positive.

An effect also from the private pension entity of R$29 million, basically due to the interest rate variation in our pension plans, which brings a loss to the company more related to the reduction in the interest rate. And the variation in Personnel, Material, Services and Other (PMSO) expenses, with a variation of R$228 million in PMSO, practically half of which is explained by the simple restatement of the price base, either by inflation or by collective bargaining agreement, for R$96 million.

Some specific items here, maintenance of machinery and lines and grid with R$32 million, basically this carry over from previous years with the postponement of maintenance that we executed now in 2017, brings an additional R$32 million in maintenance expenses.

Legal and court expenses of R$24 million, I already commented, is the provision from December 2017, basically related to a few collective labor claims which we recognized at the end of the year.

Losses with… basically here it's write-off of assets, and again it is the effect of increased Capex throughout 2017 and the preparation of the companies for the tariff review process, which happens in 2018. This brings an effect of R$22 million from the write-off of assets in operation.

Personnel expenses of R$18 million, here basically it's the program of some terminations that we made and the termination costs, again, which brings a positive reflex on the group's results from 2018. Here I wish to reinforce the collections initiatives. The reduction in defaults continues to require collection initiatives, which obviously causes an increase in Opex, here by R$9 million in 2019.

Moving on to renewable generation, a positive variation of R$228 million, the major impact here is the operational startup of the wind farms at the end of 2016, which now are already in a 12-month regime in 2017, with a reflex of R$179 million in last year's results. We also had price adjustments, basically it's the inflation pass-through, generally IPCA, in our energy sale agreements, of R$70 million.

Penalties: this is a penalty paid by CPFL Renováveis in 2016 which didn't happen again in 2017, it was a one-off penalty in 2016, so in the comparison this brings a positive effect of R$53 million on the results. As Andre said, lower generation in our wind farms, almost 11% below the curve of P50, which caused a negative impact of R$32 million in the 2017 results.

We also had lower generation at our thermal plants, basically with biomass generation, with a reflex of R$20 million in the results and, in the case of CPFL Renováveis, we have some exposure to the GSF due to our SHPs, which caused an impact of R$18 million in the results.

In conventional generation, a positive variation of R$89 million, basically due to contractual adjustments based on the IPCA, and some contracts based on the IGP-M, with a reflex of R$39 million in the results.

Our financial restatement of the use of public assets, of R$30 million, is also basically from the variation in inflation. We had lower inflation in 2017 compared to 2016, so there's a smaller restatement on the use of public assets, therefore generating a positive effect of R$30 million in the results.

And Epasa's performance. Epasa is our oil thermal power plant, whose dispatch in 2017 was higher than in 2016. Since it generates positive margin, the more the generation, higher the result, therefore an impact of R$25 million in the year.

In trading, a positive variation of R$31 million basically due to the combination of two factors: The first is the increase in price and volume in the contracts of our energy trading company, which brings an effect of R$70 million in the result; partially offset by the penalty we received in 2016 and didn't receive in 2017 from CPFL Renováveis, impacting the variation by R$57 million.

Turning to net income, a decline of R$34 million in the financial result, the major impact here is the interest rate reduction, which brings a positive effect of R$365 million on the result, basically offset by RGE Sul's results, a variation in the company's debts of R$74 million in financial expenses and, acquisition debts that bring an additional financial expense of R$186 million.

We also had variation in our derivatives, which is basically a derivative that swaps our foreign currency position for some energy sales contracts we have. Here we registered a decline of R$49 million. Just to remind that there are two positive effects here: In 2016 we have a R$68 million result from this derivative; and now also R$19 million positive, which means that the variation was negative by R$49 million.

An effect which is also important in our financial results is the reduction of revenue from installment payment of dues by consumers, of R$36 million. Here basically due to the cut in interest rates, we have lower interest being charged also from our customers.

And the exchange variation of Itaipu, a neutral reflex with R$36 million in the financial result.

Let's go to slide 11. So, here we have our debt. I think Andre also commented that we ended the year with net debt of R$14.5 billion, with leverage in a clearly downward trajectory of 3.2 times debt/EBITDA, with a very important gap in relation to our covenant of 3.75, closing with adjusted EBITDA of R$4.5 billion.
Important to see here in the debt cost curve, it is clearly a very large correlation with the fall in CDI, as more than two thirds of the company's debt is pegged to the CDI, so we have here a very clear trend of decline in the interest rate, which obviously means a decline in our debt cost as well. A decline that should continue throughout 2018.

Moving on to slide 12, here basically talking about the company's liquidity position, we ended 2017 with cash of R$2.9 billion. When we look here at our short-term debt maturities, we had, in addition to last year's closing cash balance, a funding operation of R$2.8 billion carried out by the company in January 2018, which puts us in a very comfortable situation with enough cash to meet all our short-term dues.

As usual, we are already carrying out efforts to rollover the 2019 and 2020 debts, remembering that with our average term of 2.6 years we will always have a concentration of short-term maturities, which requires an early rollover of these maturities to avoid any kind of concentration and any liquidity risk for the company.

Moving on to slide 13, at CPFL Renováveis, the SHP Boa Vista is under construction, completely on schedule, with start-up expected in 2020. The news here was the securing of financing already signed with BNDES, a process without any kind of surprise; an expectation to begin operation within the agreed period.

On page 14 we show our investment plan up to 2022. Coming on the heels of our record investment in 2017, of R$2.6 billion, the plan maintains a high volume of investment, especially in the distribution segment, where investments remain in the range of R$1.8 billion to R$2.2 billion per year, totaling R$10.4 billion in 5 years for the group. I think our challenge is to maintain the company's investments at very high levels.

And lastly, on slide 15, as Andre commented, we grouped our 5 distributors at the end of last year. So, now CPFL Santa Cruz has only one CNPJ and only one concession, which probably brings some synergy and operating gains for CPFL.

Here are the major numbers of the company: a company with almost 450,000 customers, sales of 2,800 GWh in concession areas, and a concession area of around 21,000 sq. km, it's about 1/3 of the concession area of CPFL Paulista, which is our biggest distributor.

Andre Dorf: With this, we turn the call back to the operator for the questions and answers session.

Question and Answer Session

Operator: Ladies and gentlemen, we will now begin the questions and answers session. To ask a question, please press star (*) one, and to remove your question from the queue, press star two.

Once again, to ask a question, please dial star one.

Ladies and gentlemen, to ask a question, please press star and one.

We have a question from Giuliano Ajeje, Claritas.

Mr. Giuliano: Hello everyone, Andre, Gustavo. Actually, I have three questions, the first to understand a little about the increase in non-technical losses at RGE Sul. So, if this ends up becoming an upward trend, what are you doing to reduce it? That is the first question.

The second, to understand a little about the evolution of Opex. We saw there, I think, 2017 with growth and I wanted to understand how are you going to address these lines throughout 2018.

And lastly, to understand what is your perspective on volume growth in this first quarter of 2018? Those are the questions.

Mr. Gustavo: Hello Giuliano, about our Opex, we had some nonrecurring effects that impacted our Opex in 2017, excluding obviously the inflation effect, which is a recurring effect and we will have lower pass-through starting from or throughout 2018.

I think that it may be important to say here that we are beginning a new cycle, our Zero-Based Budgeting process. To recollect, we implemented Zero-Based Budgeting at the company in 2011, and it has a cycle that generally lasts close to 5 or 6 years. We feel that it's now time for a new wave in our ZBB process, not only because of the natural cycle of this process, but also because of the changes the company went through these years, especially with growth, new companies, new projects, etc.

So, we feel we are in this moment, and I think we have a very positive expectation of seeking new productivity gains and new synergies so we can make a positive impact on our Opex curve over the coming years.

Again, just as a reminder, I think we have some nonrecurring effects in 2017, but have the challenge of seeking new productivity initiatives starting from 2018.

Moving on to your question on volume, since the end of last year we have seen significant growth in relation to market growth, with growth close to 5%.

What do we have here? I mean, the industry continues to respond to growth at about the same level as in 2017. What we notice is that here, especially for the low voltage customer, it is an important temperature effect, especially in February. February was a colder than the average, so this brought about a reduction in consumption in February, which begins to recover in March. That is to say, March comes in with an exactly opposite sign, with an increase in average temperature and, therefore, a very positive reflex in energy consumption also for low voltage customers.

Mr. Giuliano: Alright. What about expenses?

Mr. Luís Henrique: Giuliano. Hi. Luís Henrique, Vice President of Operations here. Regarding losses, they are not so different from what we were estimating in our budget. There was a small increase given the macroeconomic conditions in Rio Grande do Sul, in particular, and mainly in RGE Sul, where it serves a metropolitan region of Porto Alegre, where it most suffered from macroeconomic issues, which ended up reflecting in the losses.

We are already working hard. In fact this first year with RGE Sul was a year of integration for the company and now it has the same practices as the CPFL group, and we are already preparing an action plan on these losses to bring them to levels we consider adequate, increasing the number of inspections, increasing the number of disconnections and implementing an operational method as we have in place at the CPFL group.

Mr. Giuliano: Ok, perfect.

Operator: Ladies and gentlemen, a reminder that if you wish to ask questions, press star and one. Star and one.

The question and answer session is now finished. I would like to turn the call back to Mr. Andre Dorf for his closing remarks.

Andre Dorf: Very well. As you could see, we had an intense year here at the CPFL group, we had a transition of the controlling shareholder, we had many operational and organizational initiatives, such as the integration of RGE Sul, which Giuliano also highlighted here in the Q&A session, we had the grouping of concessions, many organizational redesigns and revision of processes within the company, yet we were able to keep our focus on operations, maintain the focus on the company's day-to-day management and deliver very consistent results.

At the same time as we looked at operations and the daily routine, we were also able to make the biggest investment in the company's history. Investments in distribution, and also in generation and transmission. As such, I emphasize here the solidity of the operations and of the company's portfolio of assets and businesses. We have been growing and delivering consistent results in the various businesses of the company, and this is also the goal for 2018; further strengthen the focus on deliveries, whether in terms of revenue or in terms of costs and expenses, as Gustavo Estrella pointed out.

I now thank all the shareholders for their trust throughout 2017, thank our employees and partners for another year of healthy results at CPFL. Thank you and have a nice day.

Operator: That concludes CPFL Energia’s conference call. Thank you all for listening and have a good day.