Local Conference Call
CPFL Energia S/A
Third Quarter 2018 Results
November 13, 2018

Operator: Good morning and thank you for waiting. Welcome to CPFL ENERGIA's Third Quarter 2018 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 want 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 the 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! Good morning, everyone. Welcome to another earnings conference call of CPFL Energia. Today we will discuss the third quarter 2018 results.

With me today are the group's main executives. As usual, we'll conduct a brief presentation and then make ourselves available for the Question & Answer session.

So, on this first screen, slide three, we highlight the increase in load in our concession area, which once again was higher in the free-market than for captive clients, as you will see later in this presentation. We also posted net income growth of 4.4%, which, combined with cost management, supported growth of 21.4% in the company's EBITDA in the quarter.

Our net debt ended the quarter at R$15.5 billion, for a net debt/EBITDA ratio of 2.92 times, which is the company's lowest leverage ratio in a long time. We also continued our investment program, with investments of just R$0.5 billion in the quarter, or R$525 million, mainly in the distribution segment. Also in the quarter, CPFL Renováveis won projects in the A-6 auction held in August and we sold two large projects, the Cherobim SHPP and the Gameleira Wind Complex.

You will see some recent developments in the industry, which include the coverage of dynamic pricing in the distribution segment to cover portion A costs. Currently, we are experiencing a coverage deficiency, which is requiring higher liquidity and working capital from all distributors in Brazil. Another development was GSF, which is a recurring topic in our discussions and now is being analyzed by the Chamber of Deputies and already has passed through the Senate, so let's see if we have something new by the end of the year.

A highly awaited development not only in the power industry, but also among all Brazilians, is the formation of the cabinet members of the new administration, especially the Minister of Mines and Energy. But such expectations also are valid for all position in the cabinet, state-owned banks, development banks, state-owned companies and the ministries. The first announcements include good officials for these positions, good news so far.

On the next page, we show the changes in EBITDA and cash generation, by business. Staring with the pie chart on the upper left, you can see our EBITDA of R$1.548 billion in the quarter, of which 46% is represented by the distribution segment, followed by renewables. This time of year is the most favorable in terms of wind and renewable energy, which explains the higher share in the comparison with prior quarters due to seasonality, and the conventional generation of 22%, followed by commercialization, services and other, which accounted for 4% of the company's EBITDA.

So, starting at the upper right, we have the distribution segment, which reported significant EBITDA growth sequentially, supported by the industry's overall growth. So, market growth explains most of this positive variation in EBITDA. Conventional generation also increased 4.7%, explained by the retroactive recovery of PIS, COFINS and CFUR tax credits in the quarter, which also supported performance in the quarter.

Renewable generation grew by the same percentage rate, of 4.7%, driven mainly by the higher wind power generation in 2018. Our wind power generation was higher in 2018 compared to the same period last year.

In commercialization, services and others, we also observed EBITDA growth, basically due to the reversal of AFDA in our trading company and to the new services and new contracts of CPFL Serviços. So we can see here a positive result from these new segments of the company.

On the next slide, we break down the distribution segment to show some highlights in the quarter. As I said before, we had a 1.2% increase in load. Meanwhile sales grew 2%, as you can see in the chart on the upper right, with free-market clients increasing their contribution to 5.4%, with captive market clients remaining practically stable.

The residential segment grew, led by RGE and RGE Sul, with the country's South region posting stronger growth due to the temperature difference between quarters, with higher temperatures in 2018.

The Commercial segment remained stable, and we have yet to see a more significant recovery in this segment. In the Industrial segment, growth was stronger, at 2.4%, with the highlights the growth at Piratininga, RGE and RGE Sul.

The recovery in the industrial segment was driven primarily by the chemicals, motor vehicles, rubber and plastic and food industries.

We continue to focus on losses and to invest in their recovery. We reported an indicator of 8.87%, which is lower than in the previous quarter and the third quarter of the last year.

On the lower left, you can see a pie chart that summarizes the market situation in the third quarter. The industrial segment continues to account for a higher share, of nearly 40%, followed by the residential, commercial and other segments. In the chart in the middle, you can see CPFL Energia's performance in relation to overall growth in various regions. In Brazil, CPFL posted sales growth of 2%, while average industry growth in the country was 1.3%. In the Southeast, CPFL grew 1.7%, compared to 2.3% for the overall market in the region, while in the South, CPFL grew 2.6%, compared to the overall growth in the region of 1.5%.

I will go into the details of the charts on the right, but they show our growth by consumer segment. But growth in the quarter was led by the residential and industrial segments, with temperature in residential segment and the slow recovery in the industrial segment the main factors.

The following slide is on generation. The main issue in generation, not just for CPFL, but also for the interconnected system, was the level of reservoirs. We started the third quarter with yellow light flashing on reservoir levels in regions and the interconnected system as a whole, but ended the quarter more optimistic, with reservoir levels starting to recovery, with the recent rainfall spurring a slight recovery in the Southeast and in the system as a whole.

This had an effect on the PLD price, as you can see in the chart on the lower left, which shows the monthly changes in the PLD price in 2018. So we started 2018 more or less in the middle of the chart, at R$180.00 to R$200.00. Because of the warnings on hydrology, the price peaked at R$505.00 and as of the first week of November was at R$142.00.

On the chart on the right, you can see the impact of hydrology on the GSF indicator, which we monitor closely and ends up having a financial impact on generation companies. September, and consequently the quarter, were marked by the worst level ever of GSF. Going forward, the trend should be of recovery, since we are entering the rainy season.

The next slide shows details of our results, for which I will hand the call over to Gustavo Estrella, our CFO.

Mr. Gustavo Estrella: On slide seven, we present our very robust quarterly results, with EBITDA growing 21.4% in the quarter and 22.5% in the nine-month period. Meanwhile, net income grew 60% in the quarter and 100.6% in the year to date. Net income in the first nine months was R$1.496 billion, which already surpassed the net income in the whole of 2017, of R$1.2 billion.

The main factor in this performance was the distribution segment, which posted positive EBITDA growth of R$230 million. The effect came from what we call "market and tariffs," with the market in the concession area expanding 1.2%. Clearly, the main effect here came from tariffs, especially the tariff reviews at our distributors. So, most this R$178 million is due to the tariff adjustments made during 2018.

Another positive effect was the inflation adjustment of financial assets, which are adjusted by the IPCA rate, which generated a gain of nearly R$90 million. There were some minor variations related to private pension entities, of R$6 million, and a negative effect from PMSO in the quarter of R$70 million. Here we have some seasonal effects, basically related to legal expenses and AFDA in the quarter, whose effects do not have a set frequency.

In the year to date, both AFDA and legal expenses were lower than in 2017. We believe that this is a positive trend when we look at the first nine months of 2018 and the year 2017.

In conventional generation, the variation was R$15 million, which, as mentioned by Andre, is due to the recovery of credits, mainly PIS and COFINS tax credits at EPASA, our thermal power plant, of R$11 million.

In renewable generation, there was a bigger effect on wind power generation, with the volume generated higher than in 2017, which makes a contribution to revenue. In 2017, we registered some penalties that did not occur in 2018, which also is a positive effect, which was partially offset by the negative GSF of R$14 million, as Andre mentioned earlier.

Another important effect on our results was due to the financial result, which posted a gain of R$101 million, basically due to lower interest rates.

Slide eight shows the changes in the leverage ratio, which returned to a level not seen since 2012, of 2.92 in the third quarter of 2018. It is important to note that our current regulatory asset is nearly R$2 billion, which also affects our leverage ratio. Excluding this effect from our regulatory asset, our debt/EBITDA ratio would stand at 2.5 times.

Note that this R$2 billion will be incorporated into the tariff adjustments during 2019, which means it will return to cash, thereby accelerating our deleveraging process during the next year.

Our debt profile remained practically stable compared to the prior quarter. Net debt with exposure to the CDI rate is practically zero, as we already mentioned, so today we have 45% of gross debt pegged to fixed rates during 2018. In 2019, we will increase our exposure to the CDI, but this year our financial expenses should remain stable through year-end.

Going to slide nine, we can see company's liquidity position. Our cash position ended the quarter at R$3.579 billion, which is sufficient to cover all shorter-dated liabilities, following the company’s previous refinancing policy to avoid any exposure to market volatility.

Slide ten shows some projects under development. The highlight is the Boa Vista SHPP. The Boa Vista SHPP, which was slated to startup in 2020, had its startup anticipated, and now it should start operating at 100% in the coming weeks, prior to the original term agreed upon in the auction.

We also have two projects that we won in the recent A-6 auction, namely the Cherobim SHPP, with 28 MW of installed capacity, and the Gameleira Wind Complex, with 69 MW of installed capacity. We are launching the development of these two projects, which are slated to startup in 2024.

Mr. Andre: This is Andre Dorf. On the last slide, we share with you one of the company’s more interesting initiatives.

We ended the third quarter with the first edition of CPFL Inova. CPFL Inova was an initiative conceived inside the company to expand the interactions among the initiatives of our business or management areas with startups and new technologies outside the company. We know that major innovations are occurring outside of large companies, and, as for any company, we have much to learn and potentially incorporate from cooperating with startups.

So, we launched this project in partnership with Endeavor, a company dedicated exclusively to developing startups and scale-ups. In our first edition, we proposed to accelerate 12 startups. We received submissions from 496 companies. You can see our solutions and interests listed on the bottom of the slide. These initiatives are very practical and interesting for our company.

This first edition produced contracts worth R$6 million with these companies, whose solutions could create or optimize processes inside the company or lead to the development of new services for the market, or solutions that optimize costs, avoid losses, deal with data differently, etc., everything that can bring more efficiency, new services and productivity to the company.

With that, I conclude the presentation and open the call up to the Q&A 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. To remove your question from the list, please press star, two.

Once again, if you have any question, please press star, one. Star, one.

Our first question comes from Bruno Varella, from Solana Capital.

Mr. Bruno: Hi Andre, hi Estrella, good morning. I have three questions. First, I want to know if you think RGE Sul's EBITDA will overtake RGE's EBITDA already this year.

Another questions is about RGE Sul, where there was an increase in quarterly EBITDA year over year. I want to know if any account was reclassified, since RGE Sul's EBITDA jumped from a loss of R$77 million in 2017 to positive R$72 million this year. I want to know if there were any reclassifications.

Lastly, could you give some details on legal expenses. You even mentioned them today, Estrella, but I want to know where these costs come from, if they have something to do with that discussion on pension funds at Paulista, and if these costs will occur again in the following quarter. Thank you.

Mr. Gustavo: Ok, Bruno, thank you for your question. Firstly, RGE Sul's EBITDA will not surpass RGE's EBITDA. In the first quarter, RGE Sul indeed did report EBITDA higher than that of RGE for the first time. Not for the year. These concession areas have relatively similar characteristics, but RGE Sul is expected to receive more investments in the coming periods. So maybe in one or two years, RGE's EBITDA could be surpassed. But not this year. RGE's EBITDA will remain higher than RGE Sul's EBITDA.

Note that these companies will merge in early 2019 and we will report results as a single company. However, in terms of business plan, the companies will continue to be analyzed separately, so that we can know exactly if the business plan we developed in 2016 is being followed, as it was defined by our Board.

You mentioned RGE Sul's EBITDA loss last year. 2017 was a year of adjustments for RGE Sul, basically in relation to PPA, which involves reclassifying the balance sheet after an acquisition. We need to know which comparison you are considering, I mean, if it is RGE Sul's individual balance sheet or RGE Sul's consolidated balance sheet, because they have different bases. I just want to know if we are talking about the same thing.

Mr. Bruno: Yes, actually, I was considering the reclassified one, not the consolidated one.

Mr. Gustavo: So, there is this difference, which is basically due to reclassifications to reflect the effects from PPA, which mainly are related to the contingencies in RGE Sul's balance sheet. If you like, we could give some more details on these variations. Nevertheless, this variation is explained by the PPA recorded in RGE Sul's individual balance sheet in 2017.

Mr. Bruno: Perfect, thanks.

Mr. Gustavo: Lastly, we mentioned legal expenses, which basically refer to civil lawsuits. Again, the third quarter alone is not a good proxy for future legal provisioning, given that there is no seasonality in the recognition of legal provisioning in our balance sheet. So, what we usually do is to compare year-to-date periods.

When we observe the nine-month period despite any different seasonality in 2017, these costs are not significant. In the comparison of the two years, we expect legal expenses, which, once again, are basically civil provisions, to decline in relation to 2017.

We believe that everything we have been doing in the company, from monitoring lawsuits to taking preventive measures against civil or labor lawsuits, is having effects on company's balance sheet.

Mr. Bruno: Excellent. Thank you. I have one more question about the leverage ratio. You mentioned an adjusted leverage ratio of 2.5 times EBITDA, and given the controlling shareholders' concern over the company's ratio of 3 times EBITDA, what ratio level do you consider comfortable for you to seek going forward and for resuming dividend payments with a slightly higher yield? Would that be around 2 or 1.5 times?

Mr. Andre: Hi, Bruno. Before we had a leverage ratio target, but the company has changed its philosophy. Before, we operated at the maximum leverage ratio, paying more dividends, but we had to accrue cash to cover shorter-dated liabilities. But that has changed.

Now we are deleveraging significantly, given that we are generating more cash and have less intensive capital projects and lower dividends in the last two years. The idea is to lower it even further, but we do not have a target ratio, but later we could reconsider the payment of more dividends in the next shareholders' meeting.

To date, we have not yet decided on the allocation of the company's future results, since there is no urgent need for shareholders.

Mr. Bruno: Perfect, thank you.

Operator: Remember: to ask any questions just press star and one.

The question and answer session is now finished. I will now hand the call back over to Mr. Andre Dorf for his closing remarks.

Mr. Andre: We are completing the first two years of our corporate transition. We have focused a lot on culture issues and on integrating the cultures. But the company is always the priority, we always seek to do what's best for the company. So, we have devoted much attention to operational aspects, with investments and organization that give us more quality, better control of information and operations and lower costs for the company. The results of these initiatives have already been seen and presented to the market. In addition to operational issues, many things are happening in the industry in terms of consolidation, M&A, privatizations.

So, I want to reinforce that we are aware of all the growth opportunities, whether organic or through auctions and acquisitions, but always with discipline.

With that, I conclude today's earnings conference call. I appreciate the trust placed in us of all of the group's shareholders and partners and your presence in today's call. Warm regards.

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