Local Conference Call
CPFL Energia S/A
Second Quarter of 2018 Results
August 21, 2018

Operator: Good morning and thank you for waiting. Welcome to CPFL Energia's second quarter of 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 from 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 as well as 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, good morning everyone and welcome to another conference call to discuss the results of CPFL Energia in the second quarter of 2018. As usual, we will have a brief presentation and then open for the questions and answers session.

Starting on slide 3, we have the highlights of the quarter, starting with the average load measured in our concession area, it grew 3.8% in the period (you will see later that most of the growth – as in the previous quarters, came from the free market, which grew around 7%). Our net operating revenue also grew, by 16.5% - you will also see later that it came mainly from the distribution segment - and EBITDA grew 33%.

Our net debt measured according to the criteria in the covenants ended the quarter at R$15.7 billion, for a leverage ratio of 3.11 times our EBITDA in the last 12 months. We also had an important funding operation of 3.4 billion in the quarter, at competitive costs. This quarter, we invested R$ 422 million across all segments where the company operates. The second quarter also saw the conclusion of the tariff review of RGE with an average effect perceived by consumers of around 21%.

With regard to growth, CPFL Geração won Lot 9 in the transmission auction held in June, we won the Maracanaú lot in Ceará, with CAPEX projected by Aneel of roughly R$100 million, and accompanied the developments on a few topics relevant to the sector during the quarter. One important topic for us is dynamic pricing versus the regulatory assets. Many of you know that we accumulate regulatory assets and here some of them are linked to GSF, to dispatching thermal plants due to hydrological issues, exchange variation on energy from Itaipu, and this should be covered by dynamic pricing, which hasn't been the case, so the company has been accumulating regulatory assets and, therefore, over the months.

Another topic that is being widely discussed in our sector is GSF, which has been impacting short-term settlements in the CCEE and its solution is also part of a bill that is in the Congress and which also addresses the privatization of the distributors of Eletrobrás, a topic that was exhaustively discussed throughout the quarter.

Very well. On slide 4, we present the breakdown of our EBITDA by segment. In the second quarter of 2018, we recorded EBITDA of R$1.370 billion, and the chart on the upper left-hand side of the slide shows the distribution by business segment. Our energy distribution segment accounted for nearly 60% of this EBITDA, followed by conventional and renewable generation, with 24% and 17%, respectively. Other businesses still represented a small share of the EBITDA in the period.

In the analysis by segment, starting with the top right chart on the slide, we present the evolution of EBITDA in the quarter and the six-month period. The important increase in EBITDA in the distribution segment, which reached R$ 768 million in the second quarter of 2018, growing by nearly 70% compared to the same period last year, was mainly due to market growth, control of PMSO and the concession financial asset, which were the three main positive impacts on EBITDA in the distribution segment.

In conventional generation, we had a small decrease, largely due to the reduction in the physical guarantee of Serra da Mesa, of Semesa, our plant. Renewable generation grew significantly by nearly 15%, and here we had several impacts that are described in our earnings release, but I'd like to highlight the startup of the Pedra Cheirosa wind power complex. And in trading, services and other segments, the highlight was our service, and network construction and maintenance segments, which positively contributed to this increase.

On the next slide, we address the distribution segment. Starting with the increase in the load and sales in the period, their growth was almost similar, at around 4%. We had significant growth in the residential and commercial segments, of 5.7% and 3.7%, which was mainly due to the high temperatures in April and May.

In the industrial segment, despite the truck drivers' strike and the impact of the economic scenario in Brazil, we recorded growth of 2.4% in the period. The highlights in the industrial segment were the steel, automotive, chemical and food industries, which contributed significantly to this growth.

The upper right chart on the slide shows the improvement of our sales in the concession area, which, like I said, grew 4% and was largely and positively influenced by clients in the free market, which grew 7.6%.

The charts at the bottom, starting from the left, show the breakdown of consumption classes, where our largest consumption segment is industrial, accounting for nearly 40%, followed by residential and commercial.

When we compare our growth with Brazil's growth and in the regions where we operate, we can also see positive evolution. For example, in the first map in the middle, you can see that Brazil sales grew 2% while CPFL grew 4%. The Southeast region grew 3.2% and we grew 4.1%, and the South region grew 4.2% and CPFL grew 3.8%. The chart on the right shows the evolution by consumption class, which we already discussed in the highlights.

On slide 6, we present delinquency, a topic that is unfortunately in vogue right now. Our allowance for doubtful accounts as a percentage of gross revenue remained under control this quarter, at 0.64% of gross revenue, which is in line with the historical average.

Here, it is worth noting the exception to the curve in the first quarter of this year, which has a lot to do with a non-recurring reversal in the allowance for doubtful accounts at RGE Sul in the first quarter, which did not and will not repeat going forward, so we are pretty much in line with the historical average.

The charts at the bottom show the total bills overdue more than 90 days, as well as the amount as a percentage of gross revenue, which too is well under control at 1.15 and our collection initiatives, on the right, in thousands of disconnections per quarter.

The chart here shows a decrease in the number of disconnections, although this is not a strategy of the company or a change in behavior, but rather due to the truck drivers' strike in May. Therefore, we should resume the same levels as in previous quarters going forward.

On page 7, we are introducing this quarter a snapshot of our operating indicators in the period and also a comparison with previous periods. The first chart at the top shows the total, technical and commercial losses, where we can see a trend of decline in total losses compared to previous periods, while technical losses also show a declining trend and commercial – or non-technical – losses also declining, but resisting a little more due to the crisis and the current economic scenario of Brazil.

The bullet points on the right list some of the company's ongoing initiatives to combat fraud and losses, so here we address the new technologies to combat energy theft, expansion of the number of clients using telemetering, improvement, modernization and shielding of the distribution grid, replacement of measurement equipment and modernization of facilities, upgrading of public lighting spots and updating of records. These are some of the initiatives adopted by the company to combat losses and frauds.

The charts at the bottom show the evolution in the DEC and FEC indicators, i.e. the duration and equivalent frequency of interruptions – so, the lower, the better. The charts about DEC show an evolution across all our distributors, a positive evolution here, a reduction in the equivalent duration of interruptions, which was also the case for the frequency of interruptions shown in the bottom line, also a positive evolution across all distributors.

We did an exercise here to calculate the weighted average of DEC, the equivalent duration of interruptions, the average weighted by the number of clients and arrived at an average of 8 hours and 74 minutes of interruption, which is equivalent to an availability of power supply of 99.9%. Therefore, the group, on average, offered service availability of 99.9%.

This set of charts here also show that, although the company has reduced costs and delivered better short-term results in recent quarters, this did not compromise the quality of services or investments. The company continued and continues to invest, to upgrade and add technology in order to offer greater quality and better indicators for our clients.

The next slide addresses the generation business, our power generation segment. The charts at the top of the page show reservoir levels, which have become a point of concern in recent months due to the severe drought we had recently. The chart on the left shows the reservoir levels in the National Interconnected System, which closed last month, or as of August 16, at 34% of their capacity compared to the historical average of 54%. In the Southeast, an important region for supply and generation of electricity, we have 31.6% compared to the historical average of 54%.

The chart on the bottom left of the slide shows the evolution of PLD, which shows a lot of volatility if we look at the last 2 years but has since remained at the ceiling of R$ 505 per MW/h.

The chart on the right shows the GSF projection. The market has been talking a lot about a recent GSF of 39%, but the GSF is measured by the factor, we can see on the chart the factor of 0.7 and 0.6 in June and July, respectively, and a negative trend of GSF, or a factor below 1 for a long period of this year. Therefore, in July, generation was 39% lower than the physical guarantee.

With this, I conclude my presentation and would like to turn the floor over to Gustavo Estrella, CFO of the Group, who will discuss the financial results.

Gustavo Estrella: On slide 9, we show the company's results in the second quarter, which were very positive and reflect the good quarter we had. This quarter we posted net revenue growth of 16.5%, EBITDA growth of 33.3% and net income growth of 265.5%.

As pointed out by Andre in the previous slides, the highlight was the distribution segment. You can see an increase of R$ 315 million in this segment, chiefly to the market and tariffs, as the market once again registered growth in energy consumption. We highlighted here the effect of higher temperatures, which increased consumption by the residential class, but there's also the effect of the tariff review process we had at RGE Sul and CPFL Paulista, which obviously have a positive impact on our results in May and June.

We also had a positive impact of the concession financial assets of R$ 106 million. There are basically 2 main effects here: The first is the restatement of inflation indices by the IPCA index; and the second is the effect of productivity indicators over COM (minor components) and CA (additional costs), which also had a positive impact on our result, totaling R$ 106 million.

We also have the impact here of private pension, of R$ 6 million compared to 2017 and, as Andre mentioned, a variation in our PMSO of R$ 36 million, I mean a reduction in this expense compared to 2017. And here the highlight was legal expenses, which decreased R$ 26 million.
Moving now to conventional generation, you can see a decrease of R$ 9 million, that is even due to the agreement we have in relation to GSF, the low exposure we have to GSF, this is a very stable business and with inflation growth, this year specifically we have the impact from the physical guarantee of Serra da Mesa, of 5%, which affected the company's results.

In renewable generation, another increase of R$ 33 million. I'd just like to remind you that this quarter we still suffered the negative impact of lower wind availability, which had a negative impact of R$ 14 million in the quarter, but which was more than offset by other effects, the first of which was the booking of PIS and COFINS tax credits, which had an impact of R$ 18 million in our results in the second quarter. There was also our participation in the MCSD auction, which also brought, due to the high prices in the free market, a positive impact of R$ 13 million on our results, and the startup of Pedra Cheirosa, which contributed R$ 8 million to the quarterly results.

Moving down from EBITDA, in net income the highlight was obviously the reduction in the interest rate, which reduced our financial expense by R$ 123 million, and also the positive impact from the mark-to-market adjustment, of R$ 58 million on our results.
Now on slide 10, we have our debt. The highlight is the reduction in our leverage ratio to 3.11 times Net Debt to EBITDA at the end of the quarter. The highlight here is perhaps the substantial growth in our LTM Adjusted EBITDA to R$ 5 billion. Note that, despite the decrease in the leverage, we are still suffering an important impact, as Andre mentioned, from regulatory assets, which make us carry in our debt R$ 1.1 billion of regulatory assets, which we will transfer to tariffs only next year.

In relation to the debt profile, we have a cost of 7.6%, virtually stable compared to the previous quarter and closely linked and pegged to the reduction in interest rates in Brazil. In relation to indexers, we have practically half of our debt today at pre-fixed rates, which were originally pegged to the CDI rate and which we swapped to pre-fixed debt, which is currently our main indicator, with very little volatility until the end of this year.

On slide 11 we present the debt amortization schedule and our liquidity. As you can see, for 2018, the company has, since the start of the year, 100% of the debt refinanced, today we are already working on refinancing for the second half of 2019. We have been doing this, as Andre mentioned, in the second half we raised R$ 3.4 billion in debt, basically to refinance existing debt, we swapped shorter- term debt for longer-term debt at lower rates, and this is a continuous process, in August we've already taken nearly R$ 1 billion basically to change this short-term debt profile.

On slide 12 we present two important highlights: First, the conclusion of the tariff review process at RGE in June, and the highlight here was the growth in regulatory EBITDA. We can see this leap of 103% to R$ 543 million for this cycle. This does not have a significant impact on the second half yet, but it will start impacting from the third quarter of 2018.

Another highlight was the company’s participation in the transmission auction, the last auction, at the end of June. We bid for 5 lots and won lot 9, Maracanaú, with an expected investment of around R$ 102 million. This will be our third transmission project here in the company, two of which we have already concluded and now this new lot that is under construction.

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, if you have any questions, please press star one.

Our first question comes from Bruno Varella of Solana Capital.

Bruno Varella: Hi, Dorf, Estrela, good morning. I have a few quick questions here. The first of them is related to consumption in the third quarter, I'd like to understand if it continues the same trend of the second quarter, growth of around 4%.

My second question: this leverage ratio of 3.1, do you think it was possible due to the stronger EBITDA after the review, or is it a leverage keeping in mind about 2.5 more towards the end of the year. Let me know if it makes sense to think of this number.

My third question: the transmission project you were awarded in Ceará, based on the discount of 54%, I arrived at a very low rate of return. So, I'd like to understand what would be an optimum Capex level for you and if you could shed some light on what would be the IRR that you see for this project.

And my last question is regarding the privatization of Cesp. Your idea is that this is a slightly more complex M&A because of the number of contingencies, but if, after the settlement made by the company with the Prosecution Office of Mato Grosso do Sul, whether this has substantially changed the way you see the privatization process.

Andre Dorf: Bruno, good morning, Andre here. I'll start with your last two questions and then Gustavo will address the questions on leverage and market growth.

Regarding our project in Ceará, we do have a much more optimized Capex than that disclosed or projected by Aneel. We don't disclose our internal Capex projection, but we can guarantee that we are maintaining the company's financial and economic discipline. So, we didn't compromise on the internal rate of return for this project, quite the opposite, it proved to be a very attractive project given our Capex projection.

Regarding Cesp, even because of our position, we are forced to analyze all growth alternatives we have in our sector, so it is in our radar. I don't know if today we would have growth alternatives closer to what we expect within our business segments. So we are assessing it, but there are other paths and alternatives that are more attractive to the company.

Gustavo Estrela: Bruno, talking about consumption in the third quarter, the expectation is for this resumption in activity to continue through the third quarter, so this is a resumption that basically started in the second half of last year and it continues. But, of course, when you compare the growth rate, given that we are coming from a higher consumption level last year, the growth rate will not be as high. We are projecting that this 4% in the second quarter will be closer to 3% in the third quarter. But at the end of the recovery it continues, which I think is what matters the most.

A second topic you mentioned, leverage, I would say this: We are clearly seeing a reduction in financial leverage, in a clear trajectory of deleveraging. A new fact we have here is this regulatory asset, which affects our leverage level in the very short term.

Today, we have regulatory assets of around R$ 1.1 billion, which is expected to grow, perhaps won't double, but will grow substantially until the end of this year.

So, we won't reach a leverage ratio of 2.5, I'd say mainly due to this high regulatory asset, but as we transfer this to tariffs over the course of 2019, we will see a more substantial decrease in our leverage. So, we won't reach 2.5 now, but without the regulatory assets, I'd say we will come close to that.

Bruno Varella: Excellent. Thank you.

Operator: The next question comes from Fabiano Rios of with Absoluty Investimentos.

Fabiano Rios: Thank you, my question has been answered already.

Operator: Excuse me, just to remind you that to ask a question, please press star one.

The next question comes from Bruno Varella of Solana Capital.

Bruno Varella: Hi guys, thank you for accepting another one. I have a question regarding losses. I understand that there is the economic aspect, which obviously affects particularly commercial losses, but talking specifically about RGE Sul, looking at the trend in the last 12 months for technical losses, you can see an increase of practically 40 bps more or less since the second quarter of 2017, and then you have a sharp decrease in non-technical losses between the fourth quarter and the first quarter and a new increase now in the second quarter.

My question is: First, what is specifically affecting these technical losses at RGE Sul that it has been growing constantly over the quarters? And what is the company doing to combat these non-technical losses? Do you see anything different from other concessions, especially here in São Paulo and also at RGE, which is extremely low for RGE's non-technical losses.

So, if you could add some color regarding this environment of Sul, that'd be great.

Luiz Henrique: Bruno, good morning, this is Luiz Henrique, Vice-President of Distribution. Regarding non-technical losses at RGE Sul, since we acquired the company, we've been doing some work to break down this calculation of losses, because what we measure is the global loss, the difference between non-technical and technical you get from the calculations done primarily for technical losses, and then you arrive at the non-technical loss by calculating the difference.

These calculations are improving month after month since we acquired the concession, leading to a better understanding, by installing adequate metering so that we could do this calculation as accurately as possible, even to know where to act. So, we did this calculation, we are breaking it down, hence the increase in technical losses, precisely because of the breakdown of the calculation and, consequently, it reduces a little the non-technical loss.

In this particular case this quarter, RGE Sul has specific seasonality aspects, due to the hydraulic condition at the southern border, where you have a lot of rice fields, so you have the hydraulic condition, which adds an absurd load that we are monitoring, and other characteristics of consumption of that company, which we are assessing, which cause a seasonality impact.

What are we doing on our side? First, to have precise calculations of this technical loss. Second, we are investing in strengthening the grid and in increasing the reliability and flexibility of the grid, which also translates into lower technical losses, but this does not reflect in the short term, it will take time before this strengthening is complete. And as for non-technical losses, we now have a project to install, as we did for our companies in São Paulo, to shield all of that company's group A, we will invest in telemetering and the entire consumption of group A will be telemetered. With this, we will monitor consumption of these clients hour by hour, minute by minute, and will be able to have a better picture and act more accurately in this group A, which is substantial in certain periods of the year.

So, for this reason, we are still acquiring knowledge and breaking down these calculations, but we already have a plan designed for the coming months.

Bruno Varella: Great, Luiz Henrique, thank you.

Luiz Henrique: Okay.

Operator: Excuse, me, once again, if you have any question, please press star 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, in this second quarter of 2018, we completed 2 years since the announcement of the corporate transition, whereby the Chinese company State Grid acquired the control of CPFL. You can see that, in this period, our company was able to maintain the company's business as usual, focusing on operations, on preserving and improving the executive team and the operations team and on the disciplined use of capital. The results we discussed today for the first half of the year show our efforts and our commitment to delivering short-term results and to the sustainability of our long-term results as well.

Therefore, I'd like to end our presentation and the discussion of the results for the second quarter by thanking all of you, once again, for listening and thanking all our shareholders for supporting us. Thank you very much.

Operator: That concludes CPFL Energia's conference call. Thank you for listening and good afternoon.